

IN THE
Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

DAVID WARE, et al., *Respondents.*

ON WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE
OF CALIFORNIA, FIRST APPELLATE DISTRICT

Supreme Court of the United States

Volume 100

No. 100

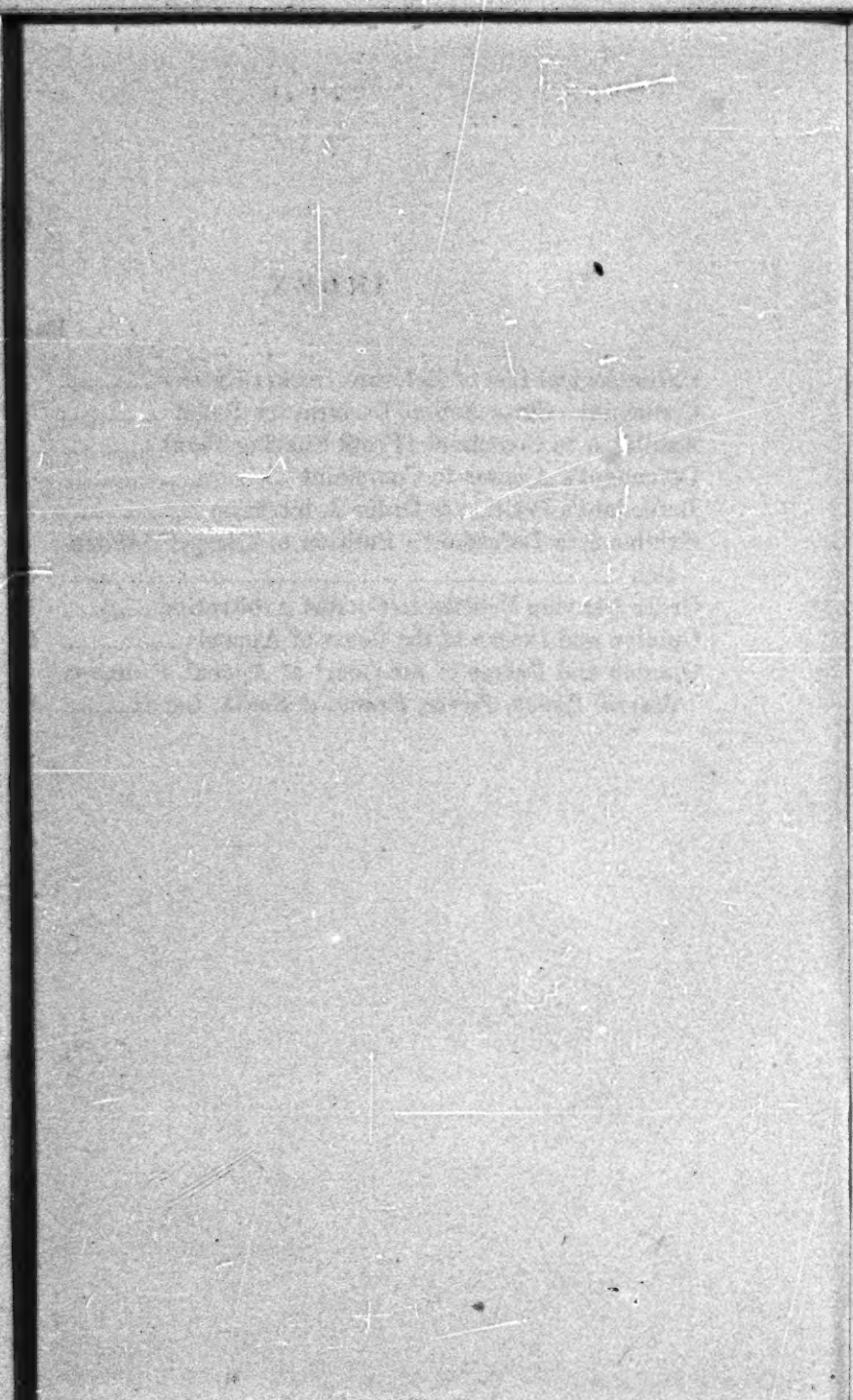
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CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

January 19, 1970—Plaintiff Ware's complaint for class action and declaratory relief filed in Superior Court of the State of California in and for the City and County of San Francisco.

April 17, 1970—Defendant Merrill Lynch's answer to complaint filed in Superior Court, City and County of San Francisco.

April 17, 1970—Defendant Merrill Lynch's petition to order arbitration filed in the Superior Court, City and County of San Francisco, together with motion to stay proceedings.

April 20, 1970—Plaintiff's motion to determine class action filed in the Superior Court, City and County of San Francisco.

April 17—June 1, 1970—Plaintiff's and Defendant's memoranda of law and declarations filed re motions.

June 8, 1970—Hearing on petition to compel arbitration, motion to stay and motion to determine class action held, Superior Court, City and County of San Francisco, Hon. Robert W. Merrill, Judge.

June 9, 1970—Order filed denying petition to compel arbitration and granting motion to determine class.

August 3, 1970—Defendant Merrill Lynch's Notice of Appeal filed.

September 22, 1970—Appeal docketed, Court of Appeal, State of California, First Appellate District, San Francisco.

March 15, 1972—Opinion and Decree of the Court of Appeal, First Appellate District, filed, affirming order denying arbitration.

April 24, 1972—Petition for Hearing in Supreme Court of California filed.

May 10, 1972—Order of Supreme Court of California denying Petition for Hearing.

August 23, 1972—Petition for Writ of Certiorari filed.

*Superior Court of the State of California, in and for the
City and County of San Francisco*

No. 612278

DAVID WARE, on behalf of himself and
all others similarly situated,

Plaintiffs,

vs.

MERRILL LYNCH, PIERCE, FENNER
& SMITH, INC., a corporation, FIRST
DOE through TWENTIETH DOE,
Defendants.

**PLAINTIFF'S COMPLAINT FOR CLASS ACTION/
DECLARATORY RELIEF**

Filed January 19, 1970

Plaintiff complains on behalf of himself, and all others similarly situated who may come in and seek relief and contribute to the expenses of this action, and for cause of action alleges as follows:

I.

There is a well-defined community of interest in the questions of law and fact involved, affecting plaintiff and all other members, in the same manner in that said action is for declaratory relief to determine under applicable California law the validity of "The Merrill Lynch Profit Sharing Plan for Employees" and particularly Article 11.1 thereof in which all have a common claim and interest.

II.

Such other persons are so numerous that it is impracticable to bring all of them before this Court as individual plaintiffs, and therefore, this plaintiff sues for himself and for the benefit of all of said persons within the said class as the names and addresses of said persons are not known.

III.

Plaintiffs do not know the true names and capacities of the defendants sued herein as FIRST DOE through TWENTIETH DOE, said names being fictitious, and plaintiffs pray that when the true names and capacities of said defendants are ascertained, that this complaint may be amended accordingly.

IV.

Plaintiffs, and each of them, are now and were at all times herein mentioned residents of the State of California, and were employed by defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a corporation, in various positions at said defendant's offices throughout the State of California, including those offices within the City and County of San Francisco.

V.

At all times herein mentioned, defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., was and now is a corporation authorized to do and doing business in the State of California with offices in the City and County of San Francisco.

4
VI

Plaintiffs, and each of them, pursuant to and during their respective employment relationship with defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., were entitled to and did in fact participate in "The Merrill Lynch Profit Sharing Plan for Employees" (The Plan), a copy of which plan is attached hereto as Exhibit "A" and incorporated herein by reference as though fully set forth.

VII

Defendants, FIRST DOE through NINTH DOE, are members of the Administrative Committee appointed by defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., to administer said profit sharing plan.

VIII

Defendants, TENTH DOE through TWENTIETH DOE, are the agents, custodians and trustees of the trust fund created under the terms of the profit sharing plan by defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

IX.

On or about July 14, 1958, at San Francisco, California, plaintiff, DAVID WARE, and defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., entered into an oral contract of employment wherein said defendant employed said plaintiff to render services for said defendant for compensation for an unspecified term.

X.

Plaintiff, DAVID WARE, accepted said employment at San Francisco, California, and agreed to render said services for defendant and in fact has performed all conditions,

covenants and promises under the said contract, on his part to be performed, within the City and County of San Francisco, State of California, the agreed place of performance.

XI

Plaintiffs by reason of their employment, and during each year of their employment, by said defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., had credited to their respective employee trust accounts certain profit sharing units in accordance with their respective salaries, which units have monetary value and represent compensation for their labor, work and effort expended on behalf of defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

XII

Pursuant to Article 5 and Article 8 of The Plan, certain of plaintiffs' profit sharing units credited to plaintiffs' accounts since December 30, 1960, have become vested and payable units upon severance of the employment relationship with defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. Plaintiff, DAVID WARE, voluntarily left the employ of defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., on March 17, 1969, in San Francisco, California, and other plaintiffs comprising the class as hereinabove defined likewise left said defendant's employ on dates presently unknown. All such plaintiffs have since entered into an employment relationship with firms involved in activities competitive with that of defendant, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

XIII.

An actual controversy has arisen and now exists between the plaintiffs and defendants concerning their respective legal rights and duties under "The Merrill Lynch Profit Sharing Plan for Employees."

XIV.

Plaintiffs, and each of them, contend that they are each entitled to a cash payment of those profit sharing units standing in their respective accounts as of the date of severance of employment in which their rights have vested and with respect to those units credited for fiscal years subsequent to the year ended December 30, 1960, pursuant to Article 7 of The Plan; that Article 11.1 of The Plan is unlawful and void under California law in that it restrains plaintiffs from engaging in a lawful profession under threat of penalty and forfeiture of vested benefits; that The Plan is part of the contract of employment; and that said defendants unlawfully breached said contract by illegally and unjustifiably refusing to pay plaintiff, DAVID WARE, and all others similarly situated, their just benefits and earned rewards.

XV.

Defendants on the other hand dispute these contentions and assert that plaintiffs are not entitled to cash payments of those profit sharing units which have been credited to the respective plaintiffs' accounts from December 30, 1960, to the dates of their respective employment termination by reason of the provisions of Article 11.1 of The Plan as each of the plaintiffs who were denied their legal rights under The Plan entered into other gainful employment with competitive firms. Defendants further assert that said Article

11.1 is lawful and valid under California law, and does not unlawfully restrain plaintiffs from engaging in other lawful professions; and that The Plan is not a part of the contract of employment.

XVI

Plaintiffs desire a judicial determination of their rights and the duties of defendants as hereinabove set out, and the amount of damages due plaintiffs respectively, if any.

WHEREFORE, plaintiffs pray for a declaratory judgment declaring the rights, duties and obligations of defendants towards defendants arising out of their employment relationship and the profit sharing plan hereinabove referenced and adjudicating that participation in The Plan is part of the employment relationship, that Article 11.1 of said plan is unlawful and void under applicable California law, that defendants are obligated to pay to plaintiffs, and each of them, all vested profit sharing units credited to their respective accounts from December 30, 1960, to their respective dates of termination, for costs of suit herein and for such other and further relief as the Court decides is just and proper.

FEENEY AND SPARKS

By /s/ JOSEPH C. BARTON

Joseph C. Barton

Attorneys for Plaintiffs

(JURAT OMITTED IN PRINTING)

Exhibit A to Complaint

THE Merrill Lynch PROFIT SHARING PLAN FOR EMPLOYEES (OTHER THAN IN CANADA)

Merrill Lynch, Pierce, Fenner & Smith Inc
70 Pine Street • New York 5, N. Y.

*Underwriters and Distributors of Investment Securities
Brokers in Securities and Commodities*

• • •

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PROFIT SHARING at MERRILL LYNCH

Our Employees "Deferred" Profit Sharing Plan was officially born in 1945, but the history of profit sharing at Merrill Lynch goes back several years earlier, to the very inception of our modern firm. When the two main predecessor firms of the present corporation—Merrill Lynch, E. A. Pierce & Cassatt, and Fenner & Beane—merged in 1941 to form one of the largest limited partnerships in the world in the face of the past decade of depression and the uncertainties of our first bleak year of World War II, the faith of those "modern Wall Street pioneers" paid off almost at once.

Although the net profit for 1941 was only half-a-million dollars, it was the first net profit of any kind in many years for all the predecessor firms involved. The Messrs. Merrill, Pierce, Fenner, Smith *et al* were fully cognizant that the tide had been turned as much by the enthusiasm and hard work of every Merrill Lyncher of whatever rank or file, as for any other reason. In 1941 the Merrill Lynch partners paid out nearly 10% of the firm's profit in a cash profit sharing distribution (or "bonus" as Wall Streeters traditionally call it). There has, fortunately, been no "losing year" since; hence no year in which some sort of profit sharing distribution was not made to Merrill Lynch employees.

It's a long haul from that original \$48,000 paid out to some 1,850 employees to the astronomical \$30.4 contribution for some 10,400 employees 25 years later, via "Cash" and "Deferred" Profit Sharing, and into the Employees Pension Plan, for 1966. Note, too, that despite a six fold increase in the number of employees involved, \$30.4 million is nearly 33% of 1966's net profit of \$91.5 million, compared with that

original nearly 10% of net profit in 1941. And we have picked up some new profit sharing terms over that 25 years. We now refer to a "Deferred" as well as "Cash" profit sharing distribution; *and* a Pension Plan!

While all three of these employee benefits are obviously of a package—a voluntary sharing by MLPF&S Inc. of its profits with its employees, intended not only to reward MLers *now* but to provide them with a nest egg for the *future*—they are also all three *individual* benefits.

The MLPF&S Employees Pension Plan is explained in detail in a separate booklet all its own.

The CASH (or "Bonus") *Profit Sharing distribution*, as applicable, is explained in your Employees Handbook, *How WE Work*. So, too, is the "Deferred" Profit Sharing Plan, but, and necessarily there, only in generalities.

The "Deferred" Profit Sharing Plan is *the* official *Profit Sharing Plan for Employees* (other than in Canada) of *MLPF&S Inc.* At this writing (1967) it is already 22 years old. The original Plan has been amended, from time to time, to bring it more closely in line with its founders' original intentions that it should reward the long term *career*-Merrill Lyncher.

As Charles E. Merrill said in 1945: "We feel that our generous 'cash payment bonus' adequately adds extra rewards for the Merrill Lynchers in any particular year who helped make that year's profits possible. But we have long since felt the need for some extra-and-above reward beyond even that for those dedicated *career* men-and-women who hitch their wagons to our Merrill Lynch star not for the short, but for the long term—who, through lean years and fat, never lessen their individual efforts, ardor, nor loyalty to and for our mutual success. It is for them that their partners have created this Merrill Lynch Employees Profit

Sharing Plan. I hope that every such loyal employee will regard this Plan as a means towards that end. I only wish that we could have 'permissible incorporation' on the N.Y. S.E., could incorporate our firm and have an Employees Pension Plan with still added benefits for such career employees, too!"

Now career-minded MLers have both!

In the next section we will discuss the Plan, as *now* constituted, in some pertinent details; then follow with a section of questions most often asked by employees, with the answers thereto of course; and finally, in the last section of this booklet, we print the full provisions of the Plan, in all their original, legal language, as amended through May 17, 1966 and as approved by the United States Treasury Department. The complete Plan may be inspected at the Personnel Department in New York City during business hours.

Incidentally: don't let the phrase "legal language" scare you; it's all perfectly clear, and furthermore, however *we* may or may not clearly interpret it in the earlier sections of this booklet, every Merrill Lyncher is strongly urged to read the official language of the Plan itself; which makes up the final section of this booklet.

NOTE . . . the Index at the end of the official Plan: this Index is by subject matter and will make it easy for you to refer directly to those Articles and Sections of the Plan containing the information you are seeking.

If, after all this, you still have some questions, please do not hesitate a moment in contacting—

The Secretary of the Administrative Committee
MLPF&S Inc. Employees Profit Sharing Plan
Home Office, 70 Pine Street, New York, N. Y. 10005

*C.E.M. did not live to see it, but on January 12, 1959, under the leadership of Directing Partner Winthrop H. Smith and Managing Partner Michael W. McCarthy (who subsequently became our first Chairman of the Board, and President, respectively), MLPF&S incorporated. In that same year, the MLPF&S Inc. Employees' Pension Plan also became reality.

FOUR Amended**MLPF&S INC.****EMPLOYEES PROFIT SHARING PLAN**

One saying we have never particularly agreed with is that "all good things come in small packages." Sometimes they come in rather large, and complicated, packages. In fact, from the ancient Assyrian Code of Hammurabi to our wonderful Constitution of the United States, to the provisions of our MLPF&S Inc. Employees Profit Sharing Plan—an excellent point could be made that "the best things in life worth having are most often anything *but* the least complicated." And you can undoubtedly make your own "excellent point" with your own favorite code, whatever it may be. . . .

In a General Information Memorandum to "All Employees" under date of August 15, 1961, the then President George J. Leness announced the first major amendments to the "Deferred Profit Sharing Plan of MLPF&S Inc." since its inception with these words:

"In 1945, after five years of straight cash profit sharing (i.e., "Bonus"), the firm adopted its present Deferred Profit Sharing Plan in order to make the future in an uncertain world more secure for all of those regularly affiliated with us. As you know, the Plan's objectives are (1) to share the profits with the employees who helped make them possible; and (2) to build each member's share up to a considerable reserve against future emergencies and retirement.

"Thus Cash profit sharing is aimed at the present, while the Deferred Profit Sharing Plan is aimed at the future—the building of a retirement nest egg for our career employees.

"With this in mind, we reviewed our Deferred Plan to determine how well it has been meeting its objective since

1945. Our review indicated that the Plan is basically sound but, like any sixteen-year-old structure, it needed some renovation in order to more closely meet its objectives; and so, several changes have been made..."

First of all, NO changes were made in the generous formula according to which the firm makes its annual contribution to this Plan (see details in Index and answer to Question 3 in the next section of this booklet). Nor were any changes made in the practice of paying a "cash bonus," on top of salaries, Deferred Profit Sharing, Pension Fund, etc.

The major changes brought about by the 1960 amendments were as follows:

✓Whereas prior to 1961 an employee was entitled to 50% of his-or-her Profit Sharing units, payable in cash upon resigning from or being terminated from Merrill Lynch after one fiscal year, for Units credited in 1961 or thereafter it is necessary that at least three fiscal years of continuous employment shall have been fulfilled before an employee is entitled to any possible cash stake in his Profit Sharing credits upon leaving the firm. Such "severance payments" now start at 30% of the total number of any one person's units (see Index under "Payments"; also the answers to Questions 12, 13, and 16 in the next section). This refers only to employees who resign or are terminated before normal retirement; and has nothing to do with "death benefits," which are referred to further along in this section.

✓The scale of "accrual of rights for units credited in 1961 and subsequently" was realigned in favor of career employees who remain with Merrill Lynch for all, or most of, their working years until retirement (see Article 9 of the official "Profit Sharing Plan").

✓The Plan's Administrative Committee has now been awarded final discretion in deciding whether a retiring or terminating employee should receive such units as he is

entitled to in installments or in one lump sum (see "Administrative Committee" in Index).

✓Provisions have now been written into the official Plan (see Article 11 of the Plan, and the answer to Question 16 in our next section) for the forfeiture of all or some benefits accruing to members of the Plan if they, a- commit any act of willful dishonesty, either against the firm *per se* or in contravention of any regulatory authority, including the willful negligence of their Merrill Lynch duties; or b- leave Merrill Lynch under certain conditions to take employment deemed by the Administrative Committee to be competitive with this corporation or any of its subsidiaries.

In addition to these major changes, the Plan has been amended from time to time to set up the Canadian deferred Profit Sharing Plan and to clarify or update certain Articles. Let us now examine our MLPF&S Inc. Profit Sharing Plan as of now, exactly as it is—

YOUR STAKE IS IN UNITS ...

Although most questions MLers might have about their Profit Sharing Plan are answered in the next "Questions & Answers" section, and of course all are answered in the final section which reprints the Provisions of the Plan in detail with an Index, the key to the whole Plan lies in one word, "Units," which we will discuss in added detail here.

Your stake in your Profit Sharing Plan is in Units—the Units that are originally assigned to you, that continue to be assigned to you so long as you remain a member of the Plan, and that grow in value over the years as the return from the Plan's invested funds comes in. Of course, like any investment, Units can go down in value too, but obviously over the long term (which is the way your Profit Sharing stake should be regarded in any event!) individual Units always have gone up in value.

Additional Units are credited annually to each member of the Plan under a formula based upon the ratio his annual compensation (including any adjusted compensation or cash bonus) bears to the compensation of all other members of the plan—to a maximum of \$18,000 per person per annum.

Each year the firm allocates so many dollars to its Employees Profit Sharing Fund; this amount is then divided by the amount each individual Unit was worth at its last evaluation (Units are revalued monthly), which results in a "total number of Units to be distributed this particular year." These Units are then distributed among all eligible MLers according to the "compensation formula" explained in the answers to Questions 6-7 next section, and in Article 3 of the Plan. Eligible employees then receive a notice from the Plan's Administrative Committee, informing them of a- the total number of Units previously to their credit; b- the number of Units credited to their individual accounts this year; and c- the total number of Units *now* to their individual credit.

For employees who were members of the Plan before 1961, there are now six different types of Units; for later members there are three. There would be no point in itemizing all these here since they are so itemized in the answer to Question 10, next section; and—of course you should refer to the Index of the Actual Provisions of the Plan. What we wish to point up here is that, since your annual notice of Units has them all lumped together, employees faced with an emergency under which they might wish to draw some "payable" units now, and wanting to know how many such, if any, they possess at this time, should refer to the Secretary of the Administrative Committee for this further breakdown on their individual positions.

The Administrative Committee also issues to all members of the Plan a semi-annual and an annual report detailing

all investments of your Profit Sharing Fund, their current status (i.e., profits *versus* losses), other pertinent information on the Plan's recent activities, and of course the latest value per Unit. Semi-annual reports usually come out during August; annual reports in February; and General Information Memoranda plus articles in *WE the People* come out whenever something noteworthy and newsworthy is to be announced.

The Profit Sharing Plan's funds are kept with the First National City Bank of New York, as custodian, under the Trusteeship of one attorney and two employees of MLPF&S Inc. This is not to be confused with actual administration of the Plan or the investment of its funds, which is the responsibility of from five to nine Administrative Committee members; duly appointed Merrill Lynchers from various Offices and Departments.

But so much for the origins, purposes, and amendments to our MLPF&S Inc. Employees Profit Sharing Plan. Let us now examine, specifically, the Plan itself, starting with some questions most commonly asked about it, and the answers thereto....

Typical Questions & Answers

ABOUT OUR DEFERRED PROFIT SHARING PLAN

1. What Is the Purpose of the Plan?

This Plan is a carefully prepared and supervised program. Its objectives are to share the profits of the firm with those who helped make them possible, and to help provide future financial security for those employees who are regularly affiliated with us.

Also, should an employee be faced with a financial emergency, some Profit Sharing Funds may be withdrawn, after a certain number of years of participation, providing such withdrawal has Committee approval.

It must be realized, however, that once units are withdrawn they cannot be returned to the Fund.

2. Who Handles the Plan?

The Administrative Committee, consisting of between five and nine members selected by the Corporation, interprets the Plan and makes all decisions necessary to carry out its provisions. Any decision by the Committee relative to the Plan will be conclusive and binding on all employees.

3. Do I Contribute to the Plan?

Definitely not. All contributions to the Plan are made solely by the Corporation. For each fiscal year, the Corporation contributes the following percentages of its net profits:

<i>If profits are:</i>	<i>The Contribution will be:</i>
Not over \$2,000,000	8% of the net profits
Over \$2,000,000 but not over \$3,000,000	\$160,000 plus 8½% of the excess over \$2,000,000
Over \$3,000,000 but not over \$4,000,000	\$245,000 plus 9% of the excess over \$3,000,000
Over \$4,000,000 but not over \$5,000,000	\$335,000 plus 9½% of the excess over \$4,000,000
Over \$5,000,000 but not over \$6,000,000	\$430,000 plus 10% of the excess over \$5,000,000
Over \$6,000,000 but not over \$7,000,000	\$530,000 plus 10½% of the excess over \$6,000,000
Over \$7,000,000 but not over \$8,000,000	\$635,000 plus 11% of the excess over \$7,000,000
Over \$8,000,000 but not over \$9,000,000	\$745,000 plus 11½% of the excess over \$8,000,000
Over \$9,000,000	\$860,000 plus 12% of the excess over \$9,000,000

4. What Happens to the Money in the Profit Sharing Trust Fund?

As you know, the Corporation's contribution is put into a trust fund for the benefit of all participants. But, this money does not lie idle—it is invested, by the Administrative Committee, in various securities, such as common and preferred stocks, corporate bonds, and United States Government obligations.

Every six months, the Administrative Committee issues a detailed report of the Fund's investments. Copies of this report are distributed to all employees, and we urge that you read these reports so you'll have a better understanding of just how your Profit Sharing Fund works for you.

The wisdom of allowing your units to remain in the Fund is demonstrated by the fact that in 1945 the unit was worth \$1.00 and at the end of 1966, was worth \$3.60.

5. Who Is Eligible to Participate?

Every full-time employee of the Corporation, except employees in Canada who are covered by a separate Profit Sharing Plan, who is employed for one full fiscal year is eligible. The necessary forms for acceptance of the Plan will be sent out each year to those employees who qualify.

Employees who are *not* eligible to participate are:

- (1) those who are employed for a normal work week of less than thirty hours, and
- (2) those who are paid on a daily or hourly basis.

6. On What Is My Share of the Contribution Based?

Your share of the Corporation's contribution, which will be expressed in units, is determined by the ratio that your compensation bears to the compensation of all eligible employees.

Compensation of an eligible employee is his fixed salary paid by the Corporation, plus any *cash* profit sharing distributions and adjusted compensation paid with respect to the fiscal year for which the contribution is being made. This compensation will not include overtime pay, reimbursement of expenses, finders' fees, suggestion awards, or similar payments. No units will be assigned with respect to annual compensation in excess of \$18,000.

7. How Do I Share in the Plan?

A participant's share is expressed in "units." The value of the unit is subject to change since it is based on the total value of the Fund at the end of each month.

At the end of each year for which a contribution is made, a number of units will be assigned to you. The quantity assigned depends upon your "compensation" for that year.

There is one other means by which you acquire units—namely, the reallocation of units that have been forfeited by participants whose employment terminated during the year. At the end of each fiscal year, the forfeited units are redistributed among those participants who were included in the Plan at the time of such forfeiture, and who continue as participants when such redistribution is made. Reallocation is based upon each Plan member's participating interest in the Trust Fund.

8. What Happens to the Units After They Are Assigned?

Units assigned to you are put into your individual profit sharing account. Your units will remain in your account until paid out by reason of withdrawal, termination, death or retirement. The conditions and terms of such payments are treated in subsequent questions.

9. Are There Different Kinds of Units?

There are several different types of units. Roughly speaking, they can be categorized as those that belong to you even if you should leave ML; those that do not belong to you and which you must forfeit if you leave the firm; and those you may withdraw while still employed. There are, of course, technical names for each of the six varieties of units into which the broad classifications above are further divided. Each type, and how it is acquired, is explained in the answer to the next question.

It must be remembered, however, that any payment from the Profit Sharing Fund is limited by the provisions of Article 11 of the Plan.

10. What Kind of Units Will I Have?

That depends upon when you begin to participate in the Plan. If your first year of participation is 1961 or later, 30%

of the total units assigned to you will be classified as *Vested Units* after the completion of 3 full fiscal years of employment and further units, up to a 90% maximum will become *Vested* as the number of years of participation required by the Plan are completed . . . meaning that if you leave ML's employ, the money represented by those units is payable to you.

However, even though *Vested* units are payable to you when you leave ML, you may not have the use of them during employment until you have completed 10 full, fiscal years of service, or have completed five years of participation in the Plan, whichever is later. At that time, and each year thereafter, a portion of your *Vested* units will become *Payable*. *Payable* means that units designated as such may be withdrawn by the participant, while he is employed, if the application for withdrawal is approved by the Plan's Administrative Committee.

All units credited for years prior to 1961 were known as *Deferred* units at the time of assignment. They remained so classified until the completion of ten full, fiscal years of service. After the ten years, and each year thereafter, a portion of the *Deferred* units became *Payable* units. If they became *Payable* before 1957, they were known as *unrestricted*, i.e., withdrawable upon request. Units becoming *Payable* after 1957 were *restricted* . . . withdrawable only with the approval of the Plan's Administrative Committee.

The provisions of the Plan before it was amended concerning certain special characteristics of the units assigned through 1960 will continue to apply.

11. A Reminder About Taxes

Aside from the advantage to you of allowing your Units to accumulate until retirement, if you should have to withdraw any of your Units because of an emergency, you would want to consider the tax aspect of such a withdrawal. Briefly, under the United States Internal Revenue Code Regulations, any amount withdrawn during employment is

reportable as ordinary income received during the year of withdrawal.

Payment made upon retirement or other termination of employment—if made in a lump sum—is reportable as a long-term capital gain for Federal tax purposes.

12. What Happens If I Leave the Corporation?

Subject to any qualifying provisions of the Plan, if you should leave the employment of the Corporation for any reason, exclusive of death, retirement, or transfer to a subsidiary, you will receive the value of *all* your Payable Units, *all* your Vested Units, and, if you have any, a *percentage* of your Deferred Units.

The percentage of the Deferred Units you will receive is as follows:

<i>Years of Employment</i>	<i>Percent Payable</i>
1-4	50%
5	55
6	60
7	65
8	70
9	75
10 or more	80

Reminder: Deferred Units can only be those Units for the years through December 30, 1960.

13. If I Leave the Corporation When Will I Get My Money?

Within six months of your severance of employment from the Corporation (resignation or release), the Committee will authorize that a distribution be made to you either in a lump sum or installments.

14. In the Event of My Death What Happens to My Share?

Each participant, at the time he becomes a member of the Plan, is required to designate a beneficiary, on a form prescribed and furnished by the Committee. This beneficiary must be acceptable to the Committee and upon death of

a participant, the beneficiary will receive the value of all the Units standing to the participant's credit.

15. At Retirement How Is My Share Handled?

Upon retirement, the Committee will direct that you receive the value of all types of units credited to you. Payment will be made in a lump sum or in installments, at the discretion of the Committee.

16. Can Benefits Be Forfeited?

Yes, benefits under the Plan can be forfeited for the following reasons:

- (1) Anyone who voluntarily terminates his employment or provokes his termination and engages in any occupation deemed by the Committee to be competitive with the Corporation or any subsidiary, forfeits all rights to Units credited for fiscal years after December 30, 1960.
- (2) If it is determined by the Committee that dishonesty on the part of a participant in connection with the business and affairs of the Corporation occurred during his employment with the Corporation, that he flagrantly and willfully violated the rules or regulations of any exchange, association, or government body having regulatory powers over the Corporation's conduct of business, or that he flagrantly neglected his duties, he forfeits all rights to units credited to him subsequent to December 30, 1960. The approval and consent of the Board of Directors of the Corporation is required for the imposition of forfeitures pursuant to this provision.

Any difference between the Official Plan and the simplified explanations that we have attempted to present through these questions and answers shall of course be governed by the Plan.

**PROVISIONS OF
PROFIT SHARING PLAN
FOR EMPLOYEES (Other than in Canada)
MERRILL LYNCH, PIERCE, FENNER & SMITH
INCORPORATED**

As amended through May 17, 1966

ARTICLE 1

Administrative Committee

1.1 The Corporation shall appoint a Committee of not less than five (5) nor more than nine (9) members to be known as the Administrative Committee (herein called the "Committee") which shall serve at the pleasure of the Corporation. The members of the Committee may but need not be employees of the Corporation. Vacancies in the Committee arising by resignation, death, removal or otherwise, shall be filled by the Corporation.

1.2 The Committee shall administer the Plan and is authorized to make such rules and regulations as it may deem necessary to carry out the provisions of the Plan. The Committee shall determine any questions arising in the administration, interpretation and application of the Plan, which determination shall be conclusive and binding on all persons.

1.3 The Committee shall have the sole power to control the investment and the reinvestment of the Trust Fund and shall direct the Trustees or such agents or custodians as shall be designated by the Trustees with respect to the exercise or non-exercise of any or all of the powers of investment conferred upon the Trustees by the Trust Agreement.

1.4 The Committee shall appoint a Chairman from among its members and a Secretary who need not be a member. The committee shall act by a majority of its members at the time in office (even though less than five (5) in

number) and such action may be taken either by a vote at a meeting or in writing without a meeting. The Committee may by such majority action authorize any two or more of its members to execute any document or documents on behalf of the Committee, in which event the Committee shall notify the Trustees in writing of such action and the names of its members so designated and the Trustees thereafter shall accept and rely upon any document executed by such members as representing action by the Committee until the Committee shall file with the Trustees a written revocation of such designation.

1.5 The Committee may appoint such agents, who need not be members of such Committee, as it may deem necessary for the effective performance of its duties and may delegate to such agents such powers and duties as the Committee may deem expedient or appropriate. The compensation, if any, of such agents shall be fixed by the Committee within limits set by the Corporation.

1.6 The acts and determinations of the Committee shall be duly recorded by the Secretary thereof. Such records, together with any documents as may be necessary for the administration of the Plan, shall be preserved in the custody of such Secretary.

1.7 The members of the Committee shall serve without compensation for services as such but all expenses of the Committee shall be paid by the Corporation. Such expenses shall include any expenses incident to the functioning of the Committee, including, but not limited to, fees of investment counsel, compensation of its agents, attorney's fees, accounting charges and other costs of administering the Plan. All disbursements by the Trustees, except for the ordinary expenses of the administration of the Trust, shall be made upon the written instruction of the Committee.

1.8 The members of the Committee, and each of them, shall be free from all liability, joint or several, for their acts, omissions and conduct, and for the acts, omissions and conduct of their duly constituted agents in the administration of the Plan herein embodied, and the Corporation shall indemnify and save them, and each of them, harmless from the effects and consequences of their acts, omissions and conduct in their official capacity, except to the extent that such effects and consequences shall result from their own willful misconduct.

ARTICLE 2

Contributions

2.1 All contributions under the Plan shall be made by the Corporation and no contributions shall be required or permitted of any employees.

2.2 The contributions of the Corporation under the Plan for each fiscal year of the Corporation shall be determined in the following manner:

(a) the net profits of the Corporation shall be determined for such fiscal year;

(b) the "Contribution Base" for such fiscal year shall be ascertained by applying the following table:

<i>If the Net Profits Are:</i>	<i>The Contribution Shall Be:</i>
Not over \$2,000,000	8% of the Net Profits
Over \$2,000,000	\$160,000 plus 8½% of the excess over \$2,000,000
but not over \$3,000,000	\$245,000 plus 9% of the excess over \$3,000,000
Over \$3,000,000	\$335,000 plus 9½% of the excess over \$4,000,000
but not over \$4,000,000	\$430,000 plus 10% of the excess over \$5,000,000
Over \$4,000,000	\$530,000 plus 10½% of the excess over \$6,000,000
but not over \$5,000,000	\$635,000 plus 11% of the excess over \$7,000,000
Over \$5,000,000	\$745,000 plus 11½% of the excess over \$8,000,000
but not over \$6,000,000	\$860,000 plus 12% of the excess over \$9,000,000
Over \$6,000,000	
but not over \$7,000,000	
Over \$7,000,000	
but not over \$8,000,000	
Over \$8,000,000	
but not over \$9,000,000	
Over \$9,000,000	

(c) a contribution Ratio shall be expressed by a fraction in which the numerator shall be the aggregate of all compensation (as defined in Section 4.5) paid or accrued by the Corporation with respect to such fiscal year to all participants in the Plan who are regularly employed other than in Canada at the end of such fiscal year, and the denominator shall be the total of the compensation paid or accrued by the Corporation with respect to such fiscal year to all such employees of the Corporation and to all employees of the Corporation participating in the Canadian Plan.

(d) the contribution of the Corporation under this Plan for such fiscal year shall be calculated by multiplying the Contribution Ratio determined under subclause (c) hereof by the Contribution Base determined under subclause (b) hereof.

The contribution by the Corporation determined as aforesaid will be paid by the Corporation to the Trustees to be held and administered in trust pursuant to the terms of the Plan and Trust Agreement. In no event, however, shall such contribution for any fiscal year exceed the amount allowable for such fiscal year under Section 404(a) (3) and (7) of the Internal Revenue Code of 1954, as amended, after giving effect to the credit and carry-over provisions of the Code, or under any statute of similar import enacted in lieu thereof.

2.3 As used herein the term "net profits" of the Corporation shall mean its net income or profits determined by the Corporation in accordance with generally accepted accounting principles and practices, adjusted as follows:

(a) No deduction shall be allowed for taxes based on income imposed by the United States.

(b) No deduction shall be allowed for the contributions to this Plan or to the Canadian Plan.

(c) No deduction shall be allowed for dividends paid on the stock of the Corporation.

(d) A deduction shall be allowed for an amount equal to 6 percent of the aggregate amount of capital. The aggregate amount of capital shall consist of the average outstanding capital stock for the fiscal year, the average paid-in surplus for the fiscal year, and the earned surplus at the beginning of the fiscal year.

(e) A deduction shall be allowed for the full amount of the contributions made to the Pension Plan of the Corporation.

(f) A deduction shall be allowed for an amount equal to dividends received from subsidiaries.

In determining the amount of the contribution to be made for any fiscal year, the Corporation shall be entitled to rely on a computation of Net Profits and of the amounts contributable for such year prepared by independent public accountants on the basis of the Corporation's records prior to the time prescribed by law for filing the federal income tax return for such year, including extensions thereof. The Corporation's determination of such contributions shall be binding on all persons, including the Trustees, the Committee and the participants and their beneficiaries. Such determination shall be final and conclusive and shall not be subject to change as a result of adjustments made in a subsequent audit by the Internal Revenue Service, *provided, however*, that the Corporation may in its discretion take into consideration all or any part of such adjustments in determining the amount of any contributions made in succeeding calendar years.

2.4 As used, the terms "fiscal year" and "year" shall mean the fiscal year of the Corporation as at the time in effect, including a calendar year, a fiscal year other than a calendar year, or a fiscal year of less than twelve (12) months' duration.

ARTICLE 3

Employees Eligible to Participate

3.1 Every employee (except those employees normally employed less than thirty (30) hours per week and those employees paid on a daily or hourly basis), who:

(a) has been continuously employed by the Corporation (or by any other employer whose business, or any part thereof, is absorbed by the Corporation, or by any predecessor of such employer and which is designated by the Corporation as an employer to which this provision shall apply) during an entire fiscal year for which a contribution is being made by the Corporation; and

(b) was employed by the Corporation in the United States at the end of such fiscal year; and

(c) has within thirty (30) days after receiving from the Committee notice of his eligibility, communicated in writing to the Committee his acceptance of participation hereunder upon the terms and conditions of this Plan, shall be eligible to participate in such contribution.

3.2 Such eligible employees shall be determined by the Committee from the Corporation's records and the Committee's determination thereof shall be conclusive and binding upon all persons.

ARTICLE 4

Crediting of Contributions

4.1 As of the end of each fiscal year for which the Corporation shall make a contribution, each employee who is eligible at such time shall be credited by the Committee with the percentage of such contribution (expressed in whole Units of equal value) which his compensation from the Corporation for the fiscal year represents of the total compensation from the Corporation of all eligible employees for such fiscal year.

4.2 For the purpose of crediting the contribution of the fiscal year ended December 31, 1945, the value of each Unit shall be \$1, and for each subsequent fiscal year's contribution, the value of such Unit shall be the amount resulting from the division of the total number of outstanding Units at the end of such fiscal year into the then value of the Trust Fund (excluding the contribution for such fiscal year). In so crediting the eligible employees, the Committee shall disregard fractions of a Unit.

4.3 The "value" of the Trust Fund shall be the fair market value of the net assets held under the Trust (including all profits and increments of any nature whatsoever) determined by the Committee as of the last Friday in December of each year and at such other time or times as to it shall seem advisable, and such determination shall be conclusive and binding upon all persons.

4.4 For the purpose of making distributions the "value" of a Unit shall be its value as determined by the Committee at such time or times as to it seems proper by dividing the total number of outstanding Units at the time of such determination into the most recent or then value of the Trust Fund as determined by the Committee under Section 4.3. Such determination of the value of a Unit shall be conclusive and binding upon all persons.

4.5 The "compensation" of an eligible employee shall be his fixed salary paid by the Corporation during the year for which the contribution is being made plus any cash profit sharing distributions and adjusted compensation paid with respect to such year but shall not include overtime pay, reimbursement for expenses, finder's fees, suggestion awards, deferred profit sharing distributions or similar payments. Notwithstanding the foregoing, the "compensation" of any employee for any fiscal year shall not exceed

a total of \$18,000. The determination by the Corporation of compensation and aggregate compensation of employees shall be conclusive upon all persons.

4.6 Every eligible employee who has been credited with Units hereunder shall be known as a "participant" and as soon as practicable after each such credit, shall be informed in writing by the Committee of the number and value of the Units then standing to his credit.

4.7 Units, the value of which has been distributed to participants, shall be canceled. Units forfeited by participants shall be reallocated as of the end of the fiscal year among continuing participants of the previous year who are then regularly employed by the Corporation in the United States in proportion to their interests in the Trust Fund.

ARTICLE 5

Classification of Units—Vesting

5.1 *With Respect to Units Credited for Fiscal Years up to and Including the Year Ended December 30, 1960:*

(a) Units credited to a participant as of the end of each fiscal year shall be classified as "Deferred Units" and shall become and be reclassified as "Payable Units" as follows, disregarding fractions of a Unit:

(i) ONE-HALF of the number of Deferred Units standing to the credit of a participant shall become Payable Units as of the March 1 following either:

- A. The completion by him of ten (10) full fiscal years of employment; or
- B. The completion by him of five (5) full fiscal years of participation in the Plan,

whichever is later, and thereafter

- (ii) If the first reclassification of Units on behalf of a participant occurred prior to 1961:
 - A. ONE-SIXTH of the Deferred Units standing to his credit on March 1, 1961 shall become Payable Units on March 1, 1961, and
 - B. ONE-SIXTH of the number of Deferred Units standing to his credit on each succeeding March 1st shall then become Payable Units.
- (iii) If the first reclassification of Units on behalf of a participant occurs in 1961 or later, ONE-SIXTH of the Deferred Units standing to his credit on each March 1st following the reclassification shall then become Payable Units.

5.2 *With Respect to Units Credited for Fiscal Years Subsequent to the Year Ended December 30, 1960:*

- (a) A participant shall have no vested rights in Units credited after the fiscal year ended December 30, 1960 unless and until he has completed three years of continuous employment. Thereafter, and until completion of five years of continuous employment he shall have a vested right in 30% of such Units allocated to his account. Upon the completion of each succeeding year after 1960 and after five years of continuous employment, such previously credited Units shall vest at the rate of an additional 10% each year up to a maximum of 90%. After completion of five years of continuous employment the new Units credited for each separate year thereafter shall vest at 30% immediately and each succeeding year an additional 10% vesting

shall be added to the Units which were vested at 30%, until the vesting in a year's Units has reached 90%.

- (b) Vested Units shall become and be reclassified as "Payable Units" as follows, disregarding fractions of a Unit:

(i) If the first reclassification of Units on behalf of a participant occurs in 1961 or later:

A. ONE-HALF of the number of Vested Units standing to his credit shall become Payable Vested Units as of the March 1st following either:

- a. The completion by him of ten (10) full fiscal years of employment, or
- b. The completion by him of five (5) full fiscal years of participation in the Plan,

whichever is later, and thereafter

B. ONE-SIXTH of the Non-Payable Vested Units standing to his credit on each succeeding March 1st shall then become Payable Vested Units.

(ii) If the first reclassification of Units on behalf of a participant occurred prior to 1961:

A. ONE-SIXTH of the Vested Units standing to his credit on March 1, 1962 shall become Payable Vested Units, and

B. ONE-SIXTH of the Non-Payable Vested Units standing to his credit on each succeeding March 1st shall then become Payable Vested Units.

- (c) "Employment" shall mean the period of uninterrupted service of the employee after April 1, 1940 as an employee of the Corporation or of any subsidiary or of any other employer whose busi-

ness, or any part thereof, is heretofore or hereafter absorbed by the Corporation, or of any predecessor of such employer and which is designated by the Corporation as an employer to which this provision shall apply.

ARTICLE 6

Distributions During Employment

6.1 *Units Becoming Payable Units on or before May 1, 1956.*

- (a) Within ninety (90) days of the receipt by the Committee of a request from a participant, the Committee shall direct the Trustees or such custodians or agents as shall be designated by the Trustees to distribute to such participant the then value of such number of Units which became Payable Units on or before May 1, 1956 as the participant shall have requested.

6.2 *Units Becoming Payable Units After May 1, 1956.*

- (a) No Participant shall have the uncontrolled right to withdraw any Units which became or will become Payable Units after May 1, 1956. However, the committee may, at its sole discretion (but with due regard for the requirements of Section 401(a) of the Internal Revenue Code of 1954, as amended) upon request of a participant, permit a withdrawal of such Payable Units when it appears to the Committee, on the basis of the participant's representations or otherwise that he is in need of and intends to use the amount of such Payable Units to acquire, provide or maintain residential property for himself and his family; to defray ordinary living expenses of himself and his family, includ-

ing costs of education, medical and dental care, taxes and insurance, or for any other purpose which the Committee may determine to be of an emergency character. The Committee shall take action on each such request within ninety (90) days after the receipt thereof; and, if it determines to permit such withdrawal, it shall forthwith direct the Trustees or such custodians or agents as shall be designated by the Trustees to distribute the then value of such Payable Units as the participant shall have requested.

ARTICLE 7

Distributions Upon Severance of Employment

7.1 Upon severance of a participant's employment [other than by reason of death, retirement, or transfer to the employment of any subsidiary of the Corporation or any subsidiary thereof (herein called "Subsidiary")], the Committee shall within six months of such severance, direct the Trustees or such custodians or agents as shall be designated by the Trustees to pay to such participant, in a lump sum or in installments, in cash or in kind, all in the sole discretion of the Committee, the following amounts:

- (a) The value of all Payable Units standing to his credit as of the date of his severance of employment plus, if such severance of employment takes place between the end of any fiscal year and the succeeding March 1, inclusive, the value of the number of Units which would otherwise become Payable Units on such succeeding March 1, and
- (b) The value of the following:
 - (i) *With respect to Units Credited for Fiscal Years up to and Including the Year Ended December 30, 1960:*

The applicable following percentage of the Deferred Units standing to his credit as of the date of his severance of employment:

- 50% after completion of the first full fiscal year of employment;
- 55% after completion of the fifth full fiscal year of employment;
- 60% after completion of the sixth full fiscal year of employment;
- 65% after completion of the seventh full fiscal year of employment;
- 70% after completion of the eighth full fiscal year of employment;
- 75% after completion of the ninth full fiscal year of employment; and 80% after completion of the tenth full fiscal year of employment and every fiscal year thereafter.

(ii) *With Respect to Units Credited for Fiscal Years Subsequent to the Year Ended December 30, 1960:*

The Units standing to his credit as of the date of his severance of employment in which his rights have vested.

ARTICLE 8

Distributions Upon Death

8.1 In the event of the death of a Participant, former Participant or retired Participant, the Committee shall direct the Trustees or such custodians or agents as shall be designated by the Trustee to distribute the then value of all Units standing to his credit (whether Payable or Deferred, Vested, or Unvested) to his designated beneficiary or beneficiaries. Each Participant, former Participant, or re-

tired Participant shall designate in writing on a form prescribed and furnished by the Committee a beneficiary or beneficiaries acceptable to the Committee. In the absence of an effective designation, the Committee is authorized to make payment to a beneficiary or beneficiaries selected by the Committee from among the natural objects of the Participant's bounty, his dependents or his estate. Any determination so made by the Committee shall be binding and conclusive upon all members of the above-described classes and upon the estate of the Participant, former Participant, or retired Participant.

ARTICLE 9

Distributions Upon Retirement

9.1 The normal retirement date of a participant shall be the first day of the month coincident with or next following his 65th birthday.

9.2 A participant may elect to postpone his retirement until the end of the calendar year of his 65th birthday without the consent of the Corporation. Continuation of employment beyond such time shall be only at the request of the Corporation and only on a year to year basis but not beyond the first day of the month coincident with or next following his 70th birthday or January 1, 1962, whichever is later. A participant whose retirement is postponed shall continue to participate in the Plan and shall become fully vested in his normal retirement date in all Units credited to his account then or thereafter.

9.3 A participant may be retired for the purposes hereof prior to attaining his normal retirement date upon becoming totally and permanently disabled or for such other reasons as may be determined by the Corporation to be a basis for retirement.

9.4 Upon the retirement of a participant, the Committee shall direct the Trustees or such custodians or agents as shall be designated by the Trustees to distribute to such participant the then value of all the Units standing to his credit (whether Payable or Deferred, Vested or Unvested) in a lump sum or installments, in cash or in kind, all in the sole discretion of the Committee.

ARTICLE 10

Transfers to and from Subsidiaries

10.1 In the event that:

- (a) a participant shall terminate employment with the Corporation by reason of transfer to the employment of any subsidiary of the Corporation or any subsidiary thereof (herein called "Subsidiary"), or
- (b) a participant shall be employed by the Corporation in Canada.

The Units then standing to his credit (whether Payable or Deferred, Vested or Unvested) shall remain credited to his account. Upon termination of continuous employment with the Corporation or a Subsidiary, the Units then standing to his credit shall be paid out to him in accordance with the provisions of the Plan pertaining to Death, Retirement and Terminations, whichever is applicable. During such periods of employment with a Subsidiary or with the Corporation in Canada:

- 1. No contributions shall be made on behalf of any participant but such periods of employment shall be included for the purposes of computing years of employment required for withdrawal privileges and the attainment of vested rights.

2. The Units standing to the participant's account shall share in the profits and losses of the Trust Fund but shall not reflect contributions which are made by the Corporation or forfeitures which occur during any such period.
3. Such Units may be withdrawn by the participant in accordance with the provisions of Article 6.

10.2 A period of uninterrupted employment with a Subsidiary or with the Corporation in Canada, which is immediately followed by employment with the Corporation other than in Canada, shall be included for the purposes of computing years of employment required for eligibility to participate in the Plan, withdrawal privileges and the attainment of vested rights.

ARTICLE 11

Forfeiture of Benefits

11.1 A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960.

11.2 In the event that at any time it is determined by the Committee that dishonesty in connection with the business and affairs of the Corporation on the part of a participant occurred during the participant's employment with the

Corporation or that a participant flagrantly and willfully violated the rules or regulations of any securities or commodities exchange, the National Association of Securities Dealers, the Securities & Exchange Commission, the Commodity Exchange Administration, or any other Governmental body having regulatory powers over the Corporation's conduct of business, such participant shall forfeit all rights to any benefits due or to become due to him from the Trust Fund with respect to units credited for fiscal years subsequent to the year ended December 30, 1960. In the event that a participant is guilty of such flagrant, willful negligence in the performance of his duties as to result in the termination of his employment or, in the case of a participant no longer employed, would have resulted in termination of his employment, such participant shall forfeit all rights to any benefits due or to become due to him from the Trust Fund with respect to units credited for fiscal years subsequent to the year ended December 30, 1960. The determination of the Committee shall be subject to review by, and shall require the approval and consent of, the Board of Directors of the Corporation.

ARTICLE 12

Trust Fund

12.1 The Corporation and the Trustees have entered into a Trust Agreement providing for the administration of the Trust Fund. Neither principal nor income of the Trust Fund shall be used for any purpose other than the exclusive benefit of participants or their beneficiaries. The Trust Agreement forms a part of this Plan and any and all rights and benefits which may accrue under this Plan shall be subject to all the terms and provisions of the Trust Agreement.

ARTICLE 13**Uniform Administration**

13.1 Whenever, in the administration of the Plan, any action is required by the Corporation or the Committee, including, but not by way of limitation, action with respect to eligibility or classification of employees, contributions or benefits, such action shall be uniform in nature as applied to all persons similarly situated and no such action shall be taken which will discriminate in favor of participants who are officers, shareholders or persons whose principal duties consist of supervising the work of others, or highly compensated participants.

ARTICLE 14**Abandonment of Interest**

14.1 It shall be the duty of each participant whose employment has terminated and who is entitled to benefits hereunder to keep the Committee advised of his mailing address. If the Committee shall be unable, within one year after any benefit becomes due from the Trust Fund to a participant, to make payment because the Committee has not been notified of the identity or whereabouts of such person, the Committee may direct that such benefit and all future benefits with respect to such person shall be forfeited and all liability for the payment thereof shall terminate.

ARTICLE 15**Payment Due An Incompetent**

15.1 If the Committee determines that any person to whom a payment is due hereunder is incompetent by reason of physical or mental disability, the Committee shall have power to cause the payments becoming due to such person

to be made to another for the benefit of the incompetent, without responsibility of the Committee or the Trustees to see the application of such payment. Payments made pursuant to such power shall operate as a complete discharge of the Committee, the Trustees and the Trust Fund.

ARTICLE 16

Inalienability of Benefits

16.1 Benefits from the Trust Fund may not be assigned or hypothecated and, to the extent permitted by law, no such benefit shall be subject to legal process or attachment for the payment of any claim against any person entitled to receive it.

ARTICLE 17

Source of Payments

17.1 Benefits payable under the Plan shall be paid or provided solely from the Trust Fund and the Corporation assumes no liability or responsibility therefor. Its obligation is limited solely to making contributions to the Trust Fund as provided in the Plan.

ARTICLE 18

Plan Not a Condition of Employment

18.1 The adoption and maintenance of the Plan shall not be deemed to constitute a contract between the Corporation and any employee or participant, or to be consideration for, or an inducement or condition of, the employment of any person. Nothing herein contained shall be deemed to give any employee or participant the right to be retained in the employ of the Corporation or to interfere with the right of the Corporation to discharge any employee or participant at any time.

ARTICLE 19

Amendment of Plan

19.1 Except as herein provided, the Corporation reserves the right to modify, alter or amend the Plan hereunder at any time and from time to time to any extent that it may deem advisable. Such amendment shall be set out in an instrument in writing duly executed on behalf of the Corporation. No such amendment shall increase the duties or responsibilities of the Trustees without their consent thereto in writing. No such amendment shall have the effect of revesting in the Corporation the whole or any part of the principal or income of the Trust Fund or of diverting any part of such principal or income to purposes other than for the exclusive benefit of the participants or their beneficiaries. No such amendment shall diminish the rights of any participant, whether vested or contingent, subject to the provisions of ARTICLE 11, with respect to contributions made prior to the date of such amendment.

ARTICLE 20

Termination of Plan

20.1 The Plan is purely voluntary on the part of the Corporation and the Corporation reserves the right to terminate the Plan and to discontinue contributions hereunder at any time. If contributions are discontinued, the rights of the then Participants in contributions theretofore made shall fully vest. If the Plan is terminated, the rights of all then Participants shall fully vest. Upon termination of the Trust the Committee shall direct the Trustees to distribute all assets remaining in the Trust Fund, after payment of any expenses properly chargeable against the Trust Fund, to the Participants in accordance with the value of the Units credited to such Participants as of the

date of such termination, in cash or in kind, and in such manner as the Committee shall in its sole discretion determine. The Committee's determination shall be conclusive upon all persons.

ARTICLE 21

Adoption of Plan by Successor Company

21.1 A successor to the business of the Corporation by whatever form or manner resulting may continue and adopt the Plan by an instrument in writing executed by such successor and by the Corporation. Such successor shall succeed to all the rights, powers and duties hereunder of the Corporation. The employment of any employee who is continued in the employ of such successor shall not be deemed to have been terminated or severed for any purpose hereunder.

ARTICLE 22

Construction of Plan

22.1 The validity of the Plan or of any of the provisions thereof shall be determined under and shall be construed according to the laws of the State of New York.

22.2 Titles to articles and headings are for general information only and the Plan is not to be construed by reference thereto.

22.3 Wherever any words are used in the masculine gender they shall be construed as though they were also used in the feminine gender in all cases where they would so apply, and wherever any words are used in the singular form, they shall be construed as though they were also used in the plural form in all cases where they would so apply.

ARTICLE 23
Preservation of Benefits

23.1 The Corporation intends to preserve the benefits accrued to employees in Canada under this Plan in respect of services performed by them in Canada as fully and to the same extent as if the said employees had remained participants in this Plan. To this end, and as soon as practicable after the effective date of the Canadian Plan and receipt of rulings requested from the Department of National Revenue in Canada and the Treasury Department of the United States with respect to qualification of the Canadian Plan and the maintenance of qualification of this Plan, the Committee shall direct the Trustees of the Trust Fund established under this Plan to transfer and pay to the Trustee under the Canadian Plan an amount equal to the aggregate of the accrued interests of such employees in the Trust Fund as of the date of such payment in respect of services rendered or performed by such employees in Canada. Coincident with such payment, said Committee will cause to be delivered to the Trustee under the Canadian Plan and to the Committee administering the Canadian Plan a statement of the individual interests of all such employees in the said aggregate amount setting forth separately for each employee:

- (a) the interests credited under this Plan for fiscal years up to and including the year ended December 30, 1960;
- (b) the interests credited under this Plan for the fiscal year subsequent to the year ended December 30, 1960;
- (c) the interests which became "payable units" (within the meaning of this Plan).

DEFENDANT'S ANSWER TO COMPLAINT

Filed April 17, 1970

Superior Court, City and County of San Francisco

[Caption omitted in printing]

Defendant **MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.**, for its answer to the complaint on file herein, admits, denies and alleges as follows:

. . .

7. Answering the allegations of paragraphs IX and X, it admits that on or about July 14, 1958, it entered into an oral contract of employment with plaintiff David Ware under which plaintiff was to render services as an account executive at its offices in the City and County of San Francisco, State of California; except as so admitted it denies specifically and generally the allegations contained in paragraphs IX and X, and in that connection alleges that it performed all of its duties and obligations under said employment contract.

8. Answering the allegations of paragraphs XI and XII, it admits that during the period of plaintiff David Ware's employment, there was allocated to his account in the Profit Sharing Plan certain numbers of "units" representing his share of the Profit Sharing Plan trust, a New York trust; it further admits that upon termination of employment by plaintiff David Ware, there were 2497 vested units and 1895 unvested units allocated to his account under the provisions of Article 5 of the Profit Sharing Plan; it further admits that on or about March 17, 1969, plaintiff David Ware voluntarily terminated his employment with defendant; it is informed and believes, and on such basis admits, that other alleged plaintiff members of the class had allocated to their Profit Sharing Plan accounts during their respective periods of employment certain

numbers of "units" representing their respective shares of the Profit Sharing Plan trust in accordance with the terms and provisions of the Plan; except as so admitted, it denies specifically and generally the allegations contained in said paragraphs and in that connection alleges that except as set forth in paragraph 3 it has no information or belief concerning the specific identities of the other alleged plaintiff members of the class and on that basis denies specifically and generally the allegations with respect thereto; it further alleges that plaintiff David Ware voluntarily terminated his employment and entered into competitive employment with defendant thereby invoking the provisions of Article 11.1 of the Profit Sharing Plan and that, pursuant to said Article 11.1, the Administrative Committee determined, on or about April 18, 1969, that plaintiff David Ware had forfeited all rights to any benefits otherwise due or to become due him from the trust fund of said Profit Sharing Plan because of such competitive employment; it further alleges that it is informed and believes and on that basis alleges that all other alleged plaintiff members of the class voluntarily terminated their employment and entered into competitive employment with defendant at various times thereby invoking the provisions of Article 11.1 of the Profit Sharing Plan pursuant to which the said Administrative Committee made determinations that each had forfeited all rights to any benefits otherwise due or to become due them from the trust fund of said Profit Sharing Plan because of such competitive employment.

. . .

11. Answering the allegations of paragraphs XV and XVI, it admits that it contends that pursuant to a determination of the Administrative Committee of said Profit Sharing Plan under Article 11.1 of said Plan, plaintiff

David Ware forfeited all rights to the benefits otherwise due or to become due him from the trust fund by reason of the fact that said plaintiff David Ware entered into competitive employment with defendant Merrill Lynch; that it is informed and believes that all other alleged plaintiff members of the class also forfeited all rights to the benefits otherwise due or to become due each of them from the trust fund by reason of the fact that a determination was made as to each by the Administrative Committee of said Profit Sharing Plan pursuant to Article 11.1 of said Plan that each engaged in competitive employment with defendant upon termination of their respective employment with defendant; that the provisions of Article 11.1 of said Plan are a reasonable restraint on competition under the laws of California or New York or any other state or the United States; that pursuant to Article 22.1, said Plan is to be construed according to the laws of the State of New York, under which Article 11.1 is lawful, valid, and enforceable; that the plan is not part of the contract of employment; and such other contentions set forth as affirmative defenses herein; except as so admitted, it denies specifically and generally the allegations contained in said paragraph.

. . .

THIRD AFFIRMATIVE DEFENSE

14. For a third affirmative defense it alleges that one of the conditions precedent to plaintiff David Ware's employment with defendant Merrill Lynch was the approval of said employment with the New York Stock Exchange; that defendant Merrill Lynch is a "member" of the New York Stock Exchange; that on or about September 26, 1958, plaintiff David Ware executed a written application for the approval of his employment as a registered representative with defendant Merrill Lynch on form RE-1

of the New York Stock Exchange, a copy of said form of which is attached hereto as Exhibit 1 and incorporated herewith; that pursuant to paragraph 30(j) of said application, plaintiff David Ware agreed that any controversy between him and any member arising out of his employment or the termination of his employment by and with such member shall be settled by arbitration at the instance of any such party in accordance with the constitution and rules then obtaining of the New York Stock Exchange; that said application was approved by the New York Stock Exchange; that plaintiff David Ware's sole remedy under the above clause set forth was and is the arbitration of any alleged dispute between him and defendant Merrill Lynch; that defendant Merrill Lynch is informed and believes, and on such basis alleges, that no demand for arbitration has been made by plaintiff David Ware to the New York Stock Exchange; it further alleges that no demand for arbitration has been made by plaintiff David Ware upon defendant Merrill Lynch; that defendant Merrill Lynch has performed all of the obligations and duties to be performed on its part under the employment contract with plaintiff David Ware and elects that the said matters in controversy be submitted to arbitration and arbitrated in accordance with the provisions of said contract; defendant is informed and believes, and on such basis alleges, that each and every other alleged plaintiff member of the class also agreed to submit any controversy to arbitration pursuant to the same said paragraph of the same said New York Stock Exchange form; that no other plaintiff member of the class has made demand upon defendant and/or the New York Stock Exchange for arbitration; and defendant elects that any and all said matters be submitted to arbitration and arbitrated in accordance with the provisions of said contract and contracts.

SIXTH AFFIRMATIVE DEFENSE

18. For a sixth affirmative defense, defendant Merrill Lynch alleges that the provisions of Article 11.1 of said Profit Sharing Plan constitute a lawful and reasonable restraint on competition.

SEVENTH AFFIRMATIVE DEFENSE

19. For a seventh affirmative defense, defendant Merrill Lynch alleges that pursuant to the provisions of Article 22.1 of said Profit Sharing Plan, said Plan is to be construed according to the laws of the State of New York; and further alleges that the provisions of Article 11.1 are lawful under the laws of the State of New York and constitute a reasonable, lawful, and valid restraint on competition.

EIGHTH AFFIRMATIVE DEFENSE

20. For an eighth affirmative defense defendant alleges that it is engaged in a world-wide securities business, doing business in all of the states of the United States and numerous foreign countries; that substantially all of its employees are eligible to and do participate in said Profit Sharing Plan; that said Profit Sharing Plan is operated as a trust with the trust residence located in the State of New York where it is administered; that said Profit Sharing Plan is administered uniformly and without discrimination as to the participants therein wherever they may be employed by defendants; that said Profit Sharing Plan is to be administered and construed in accordance with the laws of the State of New York; that Article 11.1 has been construed by the Court of Appeal of the State of New York as a valid, lawful and reasonable restraint on competition; that provisions similar to Article 11.1 have

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been construed by the highest courts of other states to be valid, lawful and reasonable restraint on competition; that said Profit Sharing Plan grants defendant the right to substantial taxation and other benefits under the laws of the United States and other states; that any declaration by this court that Article 11.1 is invalid under the laws of California would cause defendant to discriminate in the administration of said Profit Sharing Plan in violation of the laws and Constitution of the United States and the laws and constitutions of the several states or cause defendant to delete said Article 11.1 from said Profit Sharing Plan thereby denying defendant due process of law under the laws and Constitution of the United States.

. . .

WHEREFORE, defendant prays

1. That this suit be dismissed with prejudice, or that all proceedings in this action be abated until a final determination in said other action;
2. For defendant's costs of suit herein; and
3. For such other and further relief as the court deems just and proper.

Dated: April 16, 1970.

ORRICK, HERRINGTON, ROWLEY & SUTCLIFFE

By /s/ W. REECE BADER

W. Reece Bader

Attorneys for Defendant Merrill

Lynch, Pierce, Fenner & Smith, Inc.

(Jurat omitted in printing)

(Certificate of Service omitted in printing)

(Exhibits omitted in printing)

**DEFENDANT'S PETITION TO
ORDER ARBITRATION**

Filed April 17, 1970

Superior Court, City and County of San Francisco

[Caption omitted in Printing]

I

The petition of **MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.**, respectfully shows:

Petitioner, **MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.**, is a corporation organized under the laws of the State of New York and authorized to do business in the State of California.

II

On or about July 14, 1958, petitioner and **DAVID WARE**, plaintiff in the above-entitled action, entered into a contract of employment whereby said **DAVID WARE** was to render services to petitioner in the capacity of an Account Executive.

III

On or about January 10, 1959, said **DAVID WARE** became eligible to participate in petitioner's Profit Sharing Plan, and made a written election to so participate. A copy of said Plan and information delivered to plaintiff prior to his election is attached hereto as Exhibit 1 and incorporated herein.

IV

At various times during the course of his employment, petitioner made contributions to said Plan which were credited to said **DAVID WARE**'s account in said Plan.

V

On or about March 17, 1969, said DAVID WARE voluntarily terminated his employment with petitioner and entered into competitive employment.

VI

Article 11.1 of said Plan provides:

"A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation . . . and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, . . . shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960."

VII

At the time of said DAVID WARE's voluntary termination of his employment, there were 2497 vested and 1895 unvested units credited to his account in the Trust Fund.

VIII

On or about April 18, 1969, the Administrative Committee determined that said DAVID WARE had voluntarily terminated his employment with petitioner; had entered into competitive employment; and had thereby forfeited any and all rights he had to benefits in said Plan.

IX

A condition precedent to employment of said DAVID WARE by petitioner was the approval of said employment by the New York Stock Exchange, of which petitioner is a member.

X

On or about September 26, 1958, said DAVID WARE executed a written application for approval of employment

on Form RE-1 of the New York Stock Exchange; said application was approved by the New York Stock Exchange Department of Member Firms. A copy of said application is attached hereto as Exhibit 2 and incorporated herein.

XI

Paragraph 30(j) of said application states, as consideration for the approval of said employment with petitioner:

"I agree that any controversy between me and any . . . member organization arising out of my employment on the termination of my employment by and with such . . . member organization shall be settled by arbitration at the instance of any such party in accordance with the Constitution and rules then obtaining of the New York Stock Exchange."

XII

A controversy has arisen under said agreement in that said DAVID WARE has filed a lawsuit seeking a declaration that Article 11.1 of petitioner's Profit Sharing Plan is invalid and unlawful and further seeking to compel petitioner to pay over to him the value of vested units to which he alleges he was entitled upon termination of his employment.

XIII

Petitioner alleges that on or about May 17, 1969, one Anthony Cameron, a former employee of petitioner, who was and is a member of the alleged class of plaintiffs herein, filed a claim with the Division of Labor Law Enforcement, Department of Labor, State of California, for wages against petitioner; said Cameron alleged in said claim that he was entitled to the value of his vested units in petitioner's Profit Sharing Plan, which is the subject of this action, and which had been forfeited pursuant to a

determination of the Administrative Committee of said Plan under Article 11.1 thereof that said Cameron had voluntarily terminated his employment with petitioner and entered into competitive employment; on or about July 3, 1969, the Division of Labor Law Enforcement, Department of Labor, State of California, dismissed said claim on the ground that it was subject to arbitration pursuant to a written arbitration agreement between petitioner and said Cameron; and that said arbitration agreement consisted of the same said New York Stock Exchange Form RE-1, paragraph 30(j) thereof, which had been executed by said Cameron on or about November 11, 1963. A copy of said notice of dismissal is attached hereto as Exhibit 3 and incorporated by reference herein.

XIV

Petitioner is informed and believes, and on such basis alleges, that each alleged plaintiff member of the class was employed by petitioner at various times and executed the same aforesaid RE-1 form whereby each agreed in writing to arbitrate any controversy between him and petitioner arising out of his employment; that each alleged plaintiff member of the class has refused and still refuses to submit said controversy to arbitration and that petitioner has stood and now stands ready and willing to submit all controversies to arbitration pursuant to the provisions of paragraph 30(j) of said form which each alleged plaintiff member of the class executed.

XV

Petitioner has performed all of its duties and obligations under said agreements and has stood and now stands willing and ready to submit the aforesaid controversy to ar-

bitration pursuant to the provisions of paragraph 30(j) of New York Stock Exchange Form RE-1. Said DAVID WARE has refused and still refuses to submit said controversy to arbitration.

WHEREFORE, petitioner prays that an order of this Court be made finding that a written agreement to arbitrate said controversy exists and directing that petitioner and said DAVID WARE arbitrate the aforesaid controversy existing between them in the manner provided for under said Form RE-1 and for such other and further relief as the Court finds proper.

Dated: April 16, 1970.

ORRICK, HERRINGTON, ROWLEY & SUTCLIFFE

By /s/ W. REECE BADER

W. Reece Bader

Attorneys for Defendant Merrill

Lynch, Pierce, Fenner & Smith, Inc.

[Jurat omitted in printing]

[Certificate of Service omitted in printing]

[Exhibit 1 omitted in printing]

**EXHIBIT 2 TO DEFENDANT'S PETITION
TO ORDER ARBITRATION**

[Filed April 17, 1970]

FORM RE-1

• • •

NEW YORK STOCK EXCHANGE

**DEPARTMENT OF MEMBER FIRMS
APPLICATION FOR APPROVAL OF EMPLOYMENT
OF REGISTERED REPRESENTATIVE**

• • •

1. WARE, DAVID J.

Last Name First Name Initial

**2. MERRILL LYNCH, PIERCE,
FENNER & SMITH, INC.**

To Be Employed By

3. REGISTERED REPRESENTATIVE

Title or Position

4. San Francisco, California

Where to be employed

30. . . . In consideration of the New York Stock Exchange's receiving and considering this application.

(d) I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange as the same have been or shall be from time to time amended, and by all rules and regulations adopted pursuant to the Constitution, and by all practices of the Exchange.

Further, and in consideration of the New York Stock Exchange's approving this application, I submit myself to the jurisdiction of such Exchange, and I agree as follows:

(j) I agree that any controversy between me and any member or member organization arising out of my employment or the termination of my employment by and with such member or member organization shall be settled by arbitration at the instance of any such party in accordance with the Constitution and rules then obtaining of the New York Stock Exchange.

31. (Date) September 26, 1958

/s/ DAVID J. WARE

**ORDER DENYING PETITION TO
COMPEL ARBITRATION**

Filed June 9, 1970

(Caption omitted in printing)

June 8, 1970

**PETITION TO COMPEL ARBITRATION, is denied
MOTION FOR ORDER DETERMINING THAT ACTION
IS MAINTAINABLE AS A CLASS ACTION AND FOR
NOTICE TO ALL MEMBERS OF THE CLASS OF PEN-
DENCY OF CLASS ACTION, is granted.**

/s/ ROBERT W. MERRILL

Judge of the Superior Court

**OPINION AND DECREE OF THE COURT
OF APPEAL**

***In the Court of Appeal of the State of California
First Appellate District, Division Four***

Filed—Mar 15 1972

1 Civil 28875

(Sup.Ct.No. 612278)

**David Ware, on behalf of himself and all
others similarly situated,**

Plaintiff and Respondent,

vs.

**Merrill Lynch, Pierce, Fenner & Smith,
Inc., a corporation,**

Defendant and Appellant.

**Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc.
appeals, pursuant to Code of Civil Procedure section 1294,
subdivision (a), from order denying petition to order arbi-
tration.**

Questions Presented

1. Was there an arbitration agreement?
2. Is the forfeiture provision of the arbitration agreement legal?
3. Does Labor Code section 229 prohibit arbitration in this dispute?

Record

Plaintiff, a former employee of Merrill Lynch, Pierce, Fenner & Smith, Inc. (hereinafter Merrill Lynch), on behalf of himself and other former employees similarly situated, filed this action for declaratory relief and damages. The gravamen of the complaint involves a provision, Article 11.1, in the Merrill Lynch Profit Sharing Plan for Employees. The complaint seeks (1) a declaration that Article 11.1 is invalid under applicable law (Bus. & Prof. Code, § 16600), and (2) that defendant is obligated to pay to plaintiff the amount of the profit sharing rights which Merrill Lynch claims were forfeited and to which plaintiff claims to be entitled. Merrill Lynch answered and filed a petition for order of arbitration. Plaintiff then filed a motion for order determining that the action is maintainable as a class action, and filed affidavits in support of five individuals moving to have themselves made parties of record as members of the class. The petition for arbitration was denied. The motion for class action and to admit the five persons submitting affidavits as plaintiffs was granted. Merrill Lynch appeals from the order denying arbitration.

Facts

In July 1958 plaintiff Ware became an employee of Merrill Lynch at its San Francisco office as an account executive, remaining such until March 1969 when he voluntarily terminated his employment. He then became an

employee of another securities broker, competitive with Merrill Lynch. As a full-time employee of Merrill Lynch he was eligible to participate in its profit sharing plan. From time to time Merrill Lynch made contributions to this plan (employees did not contribute) which were credited to plaintiff's account in the profit sharing trust fund. At the termination of his employment plaintiff's account in the fund was credited with 733 vested units and 1,258 unvested units. When plaintiff became eligible to participate in the plan he was given an explanatory brochure and a copy of the plan.

Article 11.1 of the plan provides:

"A participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation . . . and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation . . . shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960." On April 18, 1969 the Administrative Committee of the plan made a determination that plaintiff had voluntarily terminated his employment with Merrill Lynch and had entered into competitive employment. The Committee thereupon caused to be forfeited any and all rights plaintiff had in the plan.

Merrill Lynch is a member of the New York Stock Exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. § 78f) which act authorizes the enforcement of rules and bylaws promulgated by said exchange.

Rule 345 of the exchange requires the registration and approval by the exchange of any person employed by a member in the capacity of a registered representative. Plaintiff executed a written application for approval of

employment on Form RE-1 of the exchange and was approved and registered. Paragraph 30j of the RE-1 form executed by plaintiff states:

"I agree that any controversy between me and any . . . member organization arising out of my employment on the termination of my employment by and with such . . . member organization shall be settled by arbitration at the instance of any such party in accordance with the Constitution and rules then obtaining of the New York Stock Exchange."

Defendant alleged in its petition for arbitration that all members of the class were subject to the above arbitration provision since each had individually executed the RE-1 form. This is not denied. Plaintiff contends that a class action cannot be arbitrated. Defendant claims that it is not trying to arbitrate a class action but seeking to arbitrate the dispute with the representative of the class under an agreement that also applies to all other members of the class as each has signed a similar agreement. Defendant's contention in this regard is well answered in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal. App. 3d 668, 672, where the identical contract was attacked by a former employee of Merrill Lynch: "Respondent asserts that because he brought his action in behalf of the class of persons affected by the contract arbitration should not be required. But if all employees similarly situated have signed the same arbitration agreement as that which respondent challenges, all are equally bound. If the agreement is valid, it is valid as to all members of the class. It would be inappropriate to allow respondent and the other members of the class he claims to represent to evade the terms of the agreement simply by bringing their action together as a 'class' rather than as individuals."

Section 1281.2 of the Code of Civil Procedure provides in relevant part: "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that: (a) The right to compel arbitration has been waived by the petitioner; or (b) Grounds exist for the revocation of the agreement." No contention is made that defendant waived its right to arbitration as stated in paragraph 30j of the RE-1 form.

On the record there is no substantial conflict in the facts. Where, as here, the issue is one of law only, findings of facts are not required. (*Allstate Ins. Co. v. Orlando* (1968) 262 Cal. App. 2d 858, 867.) In *Loscalzo v. Federal Mut. Ins. Co.* (1964) 228 Cal. App. 2d 391, where petition for arbitration was denied without the trial court's indicating the basis for denial, and in *Bianco v. Superior Court* (1968) 265 Cal. App. 2d 126, where petition for arbitration was granted without the court's indicating the basis for such order, it was held that the reviewing court must determine the correctness of the ruling from the record, and in doing so must determine if the record supports any of the contentions of the parties opposing the arbitration. We proceed to make such determination.

Plaintiff opposed the granting of the petition for arbitration on three basic grounds: (1) no written agreement to arbitrate existed; (2) the contract was an adhesive one and therefore revoked; (3) the issue in dispute and the legality of the forfeiture provision cannot be arbitrated.

1. Arbitration agreement.

The written agreement to arbitrate did exist. (See *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20

Cal. App. 3d 668, 671-672.) The RE-1 form expressly referred to the rules and regulations and constitution of the exchange, and contained an express representation by plaintiff to abide by them. At the time the RE-1 form was executed by plaintiff a rule of the exchange (Rule 347(b)) provided for arbitration between members and their employees arising out of the termination of the employment relationship. (2 CCH New York Stock Exchange Guide, par. 2347b.) Moreover, the RE-1 form which plaintiff admitted executing set forth in its entirety the arbitration clause 30j. Plaintiff's express representation to abide by the exchange rules charged him with the duty of knowing what the rules are. See *Gear v. Webster* (1968) 258 Cal.App.2d 57, where the appellant became a member of an association of realtors whose bylaws required submission to arbitration of controversies between members. "[B]y agreeing to abide by the bylaws appellant was bound to arbitrate her dispute with another member, here, respondent." (258 Cal.App.2d at p. 61.)

In *Larrus v. First National Bank* (1954) 122 Cal.App.2d 884, the plaintiffs opened a bank account and signed signature cards containing a printed statement that they agreed to be governed by the bylaws of the bank. Their attention was not called to the clause in dispute nor were they advised of the bank's rules. The court held the agreement binding. A reasonable person seeking employment in an industry as highly regulated as the securities exchange with knowledge of a registration requirement cannot escape the binding effect of arbitration rules referred to and expressly set forth in the RE-1 form, which he has signed, by claiming lack of knowledge of the rules integrated into the form.

The RE-1 form is a contractual agreement, even though it is headed "Application." In the application plaintiff stated "I have read the Constitution and Rules of the Board

of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors . . . as the same have been or shall be from time to time amended, and by all the rules and regulations adopted pursuant to the Constitution and by all practices of the Exchange."

The approval and registration by Merrill Lynch made the application a contract between the parties.

In *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20 Cal.App.3d 668, the identical situation arose as in this case. Frame was a former employee of Merrill Lynch who voluntarily left their employment and entered competitive employment. As did plaintiff here, he filed an action to have the forfeiture provision of his application for employment declared void. The defendant petitioned for an order requiring arbitration of all issues. The petition was denied by the trial court, which action the reviewing court held erroneous. Involved was the identical form of application for employment involved in this action. There, as does plaintiff here, Frame although he admitted signing the application contended that there was no binding agreement between him and Merrill Lynch for arbitration because there was no mutual assent to the arbitration provision as he was unaware of the clause because he did not read it. To this contention the reviewing court answered: "But failure to read a contract before signing is not in itself a reason to refuse its enforcement. (*Oakland Bank of Commerce v. Washington* (1970) 6 Cal.App.3d 793, 800.)" (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra* at p. 671; *Frederico v. Frick* (1970) 3 Cal.App.3d 872, 875.)

Just as plaintiff does here, Frame contended that Merrill Lynch was not a party to the agreement. The court said: "Respondent claims that appellant cannot enforce the agreement to arbitrate because appellant was not a party to it.

The arbitration agreement was indeed contained not in a contract form but in a New York Stock Exchange form, entitled 'APPLICATION FOR APPROVAL OF EMPLOYMENT OF REGISTERED REPRESENTATIVE.' But the form was an indispensable part of the arrangements by which respondent was employed by appellant. The subject matter of the 'application' was the approval of respondent's employment by appellant, the form was witnessed by an officer of appellant, and investigation and substantiation of the fact assertions in the application were entrusted to appellant. The application was part of the larger transaction by which appellant and respondent entered into a continuing employment relationship. Therefore, the arbitration provision is not unenforceable because of lack of mutuality." (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, at pp. 671-672.)

2. *The legality of the forfeiture clause.*

Frame made the same contention in his case as does plaintiff here, concerning clause 1.11: "The profit-sharing plan under which respondent claims benefits contains a provision that an employee who voluntarily terminates his employment and works for a competitor forfeits his rights to benefits under the plan. Respondent contends that the forfeiture provision is unlawful as being in restraint of trade under Business and Professions Code section 16600. In *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d 239, 242 (42 Cal.Rptr. 107, 398 P.2d 147), the court held invalid under section 16600 a closely analogous provision. In *Muggill* a retired employee went to work for a competitor of his former employer; retirement fund benefits were terminated under a clause similar to the one here in question.

We are persuaded that, under *Muggill*, the forfeiture provision is ineffective under California law.

"... Business and Professions Code section 16600 explicitly declares that 'every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.' The California Supreme Court in *Muggill v. Reuben H. Donnelley Corp.*, *supra*, 62 Cal.2d 239, at page 242, has on closely similar facts held a forfeiture provision to be invalid. We conclude from the California Supreme Court's treatment of the problem that section 16600 does represent a 'strong public policy' of this state." (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20 Cal.App.3d at pp. 672, 673.) Thus, it is clear that the forfeiture clause is invalid and cannot be enforced here.

3. Labor Code section 229

Defendant contends that plaintiffs argument regarding Labor Code section 229 was not presented to the trial court and is newly raised on appeal. Therefore it should not be considered. If considered, defendant submits that it was reversible error by the trial court in failing to prepare mandatory findings of fact and conclusions of law.

Defendant's contention that the effect of Labor Code section 229 cannot be considered on appeal is without merit. A legal theory to sustain a judgment may be considered on appeal even though it was not raised in the trial court, as long as it does not raise factual issues not presented to the trial court. (*Allstate Ins. Co. v. Orlando*, *supra*, 262 Cal. App.2d 858, 867.) Facts sufficient to sustain such theory under Labor Code section 229 were presented to the trial court. Therefore, Labor Code section 229 should be considered in determining the correctness of the trial court's order.

The *Frame* court did not consider the effect of section 229 of the Labor Code on the arbitration agreement. This section provides that "Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained *without regard to the existence of any private agreement to arbitrate.*" (Emphasis added.) Wages are defined in section 200 of the Labor Code as including "all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

No cases have construed section 229 of the Labor Code, but the intent appears quite clear. While the strong public policy of the state favors arbitration (*Federico v. Frick, supra*, 3 Cal.App.3d 872, 875), the intent of the statute is to provide in the first instance a judicial forum where there exists a dispute as to wages. Since the intent is clear, the only determination which must be made is whether the profit sharing benefits constitute wages within Labor Code section 200, *supra*. "[P]ursuant to the present day concept of employer-employee relations, the term 'wages' should be deemed to include not only the periodic monetary earnings of the employee but also the other benefits to which he is entitled as a part of his compensation. [Citations.]" (*Wise v. Southern Pac. Co.* (1970) 1 Cal.3d 600, 607.) A bonus, offered as an incentive to attract employees, has been held to be wages. (*Hunter v. Ryan* (1930) 109 Cal. App. 736, 738.) Payments to a health and welfare fund by an employer (*People v. Alves* (1957) 155 Cal.App.2d Supp. 870, 872), payment of insurance premiums by an employer (*Foremost Dairies v. Industrial Acc. Com.* (1965) 237 Cal. App.2d 560, 580), payments to an unemployment insurance fund (*People v. Dennis* (1967) 253 Cal.App.2d Supp. 1075, 1077), and pension plan benefits (*Hunter v. Sparling* (1948)

87 Cal.App.2d 711, 725) are wages within the meaning of the statute. In its legal sense, the word "wage" has been given a broad, general definition so as to include compensation for services rendered without regard to the manner in which such compensation is computed. (*Estate of Hollingsworth* (1940) 37 Cal.App.2d 432, 436.)

In the profit sharing plan in question, it is stated that such employee benefits, a voluntary sharing by Merrill Lynch, etc. of its profits with its employees, is intended not only to reward the employees, but also to provide a nest egg for the future. All contributions to the plan are made by the employer. The employee's share is determined by the ratio that his compensation bears to the compensation of all eligible employees.

The profit sharing plan is clearly an inducement to employees by a plan through which they benefit financially in proportion to their compensation. Consequently, defendant's contributions to the plan should be considered wages within the meaning of Labor Code sections 200 and 299. [sic] Therefore, section 229 must apply to plaintiff's claim, giving him the right to bring his claim in court in spite of any agreement to arbitrate.

"Profit sharing ordinarily signifies the participation of employees with their employer in a given share of the profits of an enterprise by reason of their labor" (*Durkee v. Welch* (S.D.Cal. 1931) 49 F.2d 339, 341.)

Section 229 of the Labor Code was adopted in 1959 (Stats. 1959, ch. 1939, § 1, p. 4532). The California Arbitration Act was revised in 1961 (Stats. 1961, ch. 461, § 2, p. 1540 [now included in Code Civ. Proc., §§ 1280-1294.2]). The fact that the Legislature has not seen fit to amend or repeal section 229 in the approximately 11 years since the revision of the Arbitration Act precludes any claim that section 229 is no longer in effect.

There is nothing in the Arbitration Act to indicate that the public policy inherent in section 229, namely that an employee cannot be required to arbitrate a claim for wages, which arbitration might not take place in California, has changed in any respect.

We hold that the forfeiture provision of the agreement is illegal and that arbitration will not lie. It therefore becomes unnecessary to consider the other contentions of the parties.

The only issue before us on this appeal is the validity of the trial court's order denying respondent's petition for arbitration. Any other issues under the pleadings may of course be considered by the trial court.

It should be pointed out that the order making this a class action limits the plaintiffs to plaintiff Ware, the five persons designated as additional plaintiffs, and residents of California who voluntarily left the employ of Merrill Lynch and entered into employment with competitive firms and who were not paid profit sharing units by reason of Article 11.1.

Order affirmed.

Certified for publication.

BRAY, J.*

We concur:

DEVINE, P. J.

RATTIGAN, J.

*Retired Justice of the Court of Appeal sitting under assignment by the Chairman of the Judicial Council.

OPINION AND DECREE OF THE COURT OF APPEAL
in Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed Oct 19 1971

1/Civil 28135

(Sup.Ct.No. P 16598)

Ronald Frame, a former employee of
Merrill Lynch, Pierce, Fenner & Smith
Incorporated, on behalf of himself and all
other former employees similarly situated,

Plaintiff and Respondent,

vs.

Merrill Lynch, Pierce, Fenner & Smith
Incorporated, a corporation,

Defendant and Appellant.

Merrill Lynch, Pierce, Fenner & Smith, Inc. appeals from an order denying its petition for arbitration of issues raised in an action brought by respondent Ronald Frame.

Respondent, a former employee of appellant, commenced an action seeking a determination that a portion of a purported agreement between appellant and respondent, which provides for forfeiture of profit-sharing rights by any employee of appellant who resigns and then engages in competition with appellant, is void as a restraint on competition condemned by Business and Professions Code section 16600. Appellant pleaded as a defense that respondent had executed an agreement to arbitrate any dispute. Concurrently, appellant petitioned the court for an order requiring arbitration of all issues (see Code Civ. Proc., § 1281.2). The

trial court denied appellant's petition for arbitration, upon the determination (made on affidavits) that "there is no binding agreement between Ronald Frame and defendant to arbitrate this controversy." The present appeal followed. We have concluded that it was error to withhold giving effect to the arbitration clause.

We note preliminarily that the order denying arbitration was based on no findings of fact or conclusions of law other than the recital that "there is no binding agreement . . . to arbitrate this controversy." Although Code of Civil Procedure section 1291 might appear to create an absolute requirement of findings to support such an order, it has been held that the requirement of section 1291 must be read as conforming to the general rules governing findings of fact in civil actions. (*Allstate Ins. Co. v. Orlando* (1968) 262 Cal.App.2d 858, 867.) Here neither party requested findings of fact or conclusions of law; therefore the court's failure to make findings was not error. (Code Civ. Proc., § 632.) Therefore, the order denying arbitration is to be upheld if the record supports it on any theory.

It was a condition of respondent's employment that he be approved by the New York Stock Exchange, of which appellant is a member. Respondent admits that he signed a stock exchange application form which contained an agreement to arbitrate "any controversy between me and any member or member organization arising out of my employment or the termination of my employment by and with such member or member organization . . ." Respondent contends that the agreement to arbitrate was unenforceable because there was no mutual assent to that provision. Specifically he contends that he was unaware of the clause because he did not read it. But failure to read a contract before signing is not in itself a reason to refuse its en-

forcement. (*Oakland Bank of Commerce v. Washington* (1970) 6 Cal.App.3d 793, 800.)

Respondent claims that appellant cannot enforce the agreement to arbitrate because appellant was not a party to it. The arbitration agreement was indeed contained not in a contract form but in a New York Stock Exchange form, entitled "APPLICATION FOR APPROVAL OF EMPLOYMENT OF REGISTERED REPRESENTATIVE." But the form was an indispensable part of the arrangements by which respondent was employed by appellant. The subject matter of the "application" was the approval of respondent's employment by appellant, the form was witnessed by an officer of appellant, and investigation and substantiation of the fact assertions in the application were entrusted to appellant. The application was part of the larger transaction by which appellant and respondent entered into a continuing employment relationship. Therefore, the arbitration provision is not unenforceable because of lack of mutuality.

Respondent next attempts to invoke the doctrine of adhesion contracts to invalidate the arbitration clause. It is true that where the bargaining strength of contracting parties is unequal a contractual provision may be construed to give effect to the reasonable expectations of the weaker party when necessary to avoid injury or unfair imposition which it is shown would be the result of giving literal effect to the terms of the contract. (See Comment (1967) 1 U.S.F. L.Rev. 306.) Here, assuming that the contract was adhesionary, it is not shown that arbitration would be contrary to the reasonable expectations of any party or that any loss or unfair imposition would result. Therefore no basis exists in the present case for using the doctrine of adhesion contracts to avoid arbitration. (*Cf. Federico v. Frick* (1970) 3 Cal.App.3d 872, 875.)

Respondent asserts that because he brought his action in behalf of the class of persons affected by the contract arbitration should not be required. But if all employees similarly situated have signed the same arbitration agreement as that which respondent challenges, all are equally bound. If the agreement is valid, it is valid as to all members of the class. It would be inappropriate to allow respondent and the other members of the class he claims to represent to evade the terms of the agreement simply by bringing their action together as a "class" rather than as individuals.

The profit-sharing plan under which respondent claims benefits contains a provision that an employee who voluntarily terminates his employment and works for a competitor forfeits his right to benefits under the plan.¹ Respondent contends that the forfeiture provision is unlawful as being in restraint of trade under Business and Professions Code section 16600. In *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d 239, 242, the court held invalid under section 16600 a closely analogous provision. In *Muggill* a retired employee went to work for a competitor of his former employer; retirement fund benefits were terminated under a clause similar to the one here in question. We are persuaded that, under *Muggill*, the forfeiture provision is ineffective under California law. Appellant points out, however, that the contract contains an express provision that the rights of the parties will be governed by the law of New York. It is conceded that under New York law the forfeiture provision is valid; it would not be treated

1. "11.1 A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960."

as being in restraint of trade as it would be under California law. (See *Kristt v. Whelan* (1957) 164 N.Y.S.2d 239, aff'd 5 N.Y.2d 807, 809.)

The next question is whether the provision specifying New York law is valid. As a general rule, it is said that contracting parties may by agreement specify what law is to control their contract if "enforcement of the contract by a local court in accordance with the foreign law agreed to be controlling does not result in an evasion of the settled public policy or a statute of the forum protecting its citizens." (11 Cal.Jur.2d, § 55, p. 138.)

We recognize that the choice-of-law question is not foreclosed by the existence of an applicable California statute where New York State has substantial contacts with the transaction and the parties, if no attempt to evade California law appears. But an agreement designating applicable law will not be given effect if it would violate a strong California public policy. (*Ury v. Jewelers Acceptance Corp.* (1964) 227 Cal.App.2d 11, 20; cf. *People v. Globe & Rutgers Fire Ins. Co.* (1950) 96 Cal.App.2d 571, 575 [upholding contract provisions designating applicable law].) Here Business and Professions Code section 16600 explicitly declares that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." The California Supreme Court in *Muggill v. Reuben H. Donnelley Corp.*, *supra*, 62 Cal.2d 239, at 242, has on closely similar facts held a forfeiture provision to be invalid. We conclude from the California Supreme Court's treatment of the problem that section 16600 does represent a "strong public policy" of this state. Therefore the agreement for application of New York law must not be allowed to defeat that policy.

It does not follow, however, that the entire contract was necessarily unlawful. Issues of law and fact may emerge

as to the severability of the unlawful penalty provision. A latent question exists as to whether the agreements of the parties may be construed as applying only to such permissible subjects of restraint as breaches of confidence and misappropriation of trade secrets. Other questions may be raised as to the time and circumstances of respondent's employment and the amount of any benefits earned and remaining unpaid. All of these matters, whether they involve questions of law or questions of fact, are in the first instance properly subject to arbitration. (*In re Frick* (1933) 130 Cal.App. 290, 292.) If the award wrongly gives effect to an unlawful contractual provision, it will be subject to attack on the hearing of any petition for confirmation. (See *Loving & Evans v. Blick* (1949) 33 Cal.2d 603.)

The order denying arbitration is reversed. v

.....
CHRISTIAN, J.

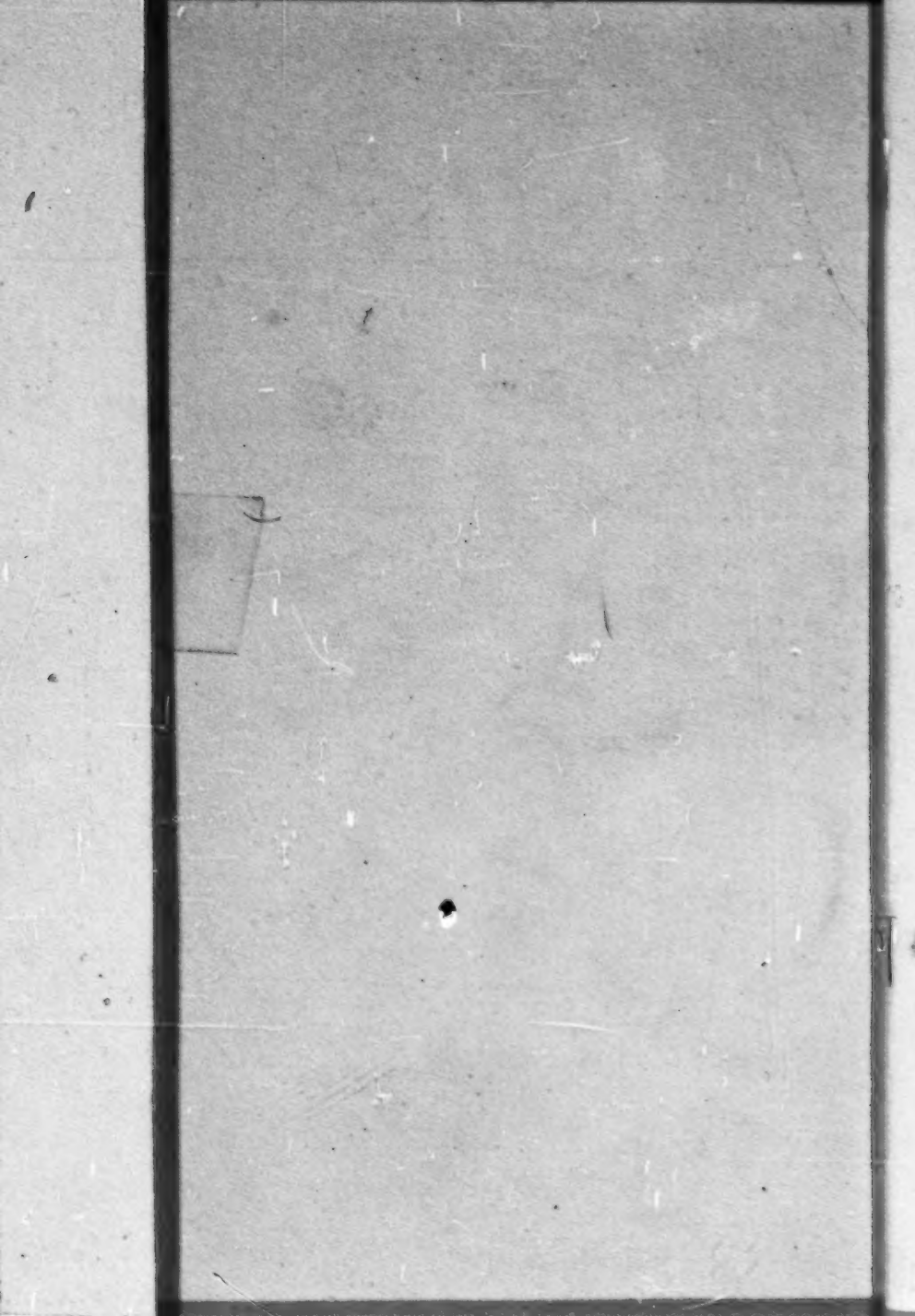
We concur:

.....
DEVINE, P. J.

.....
DAVID, J.*

*Assigned by the Chairman of the Judicial Council.





In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72 - 312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,
v.
DAVID WARE, et al.,
Respondents.

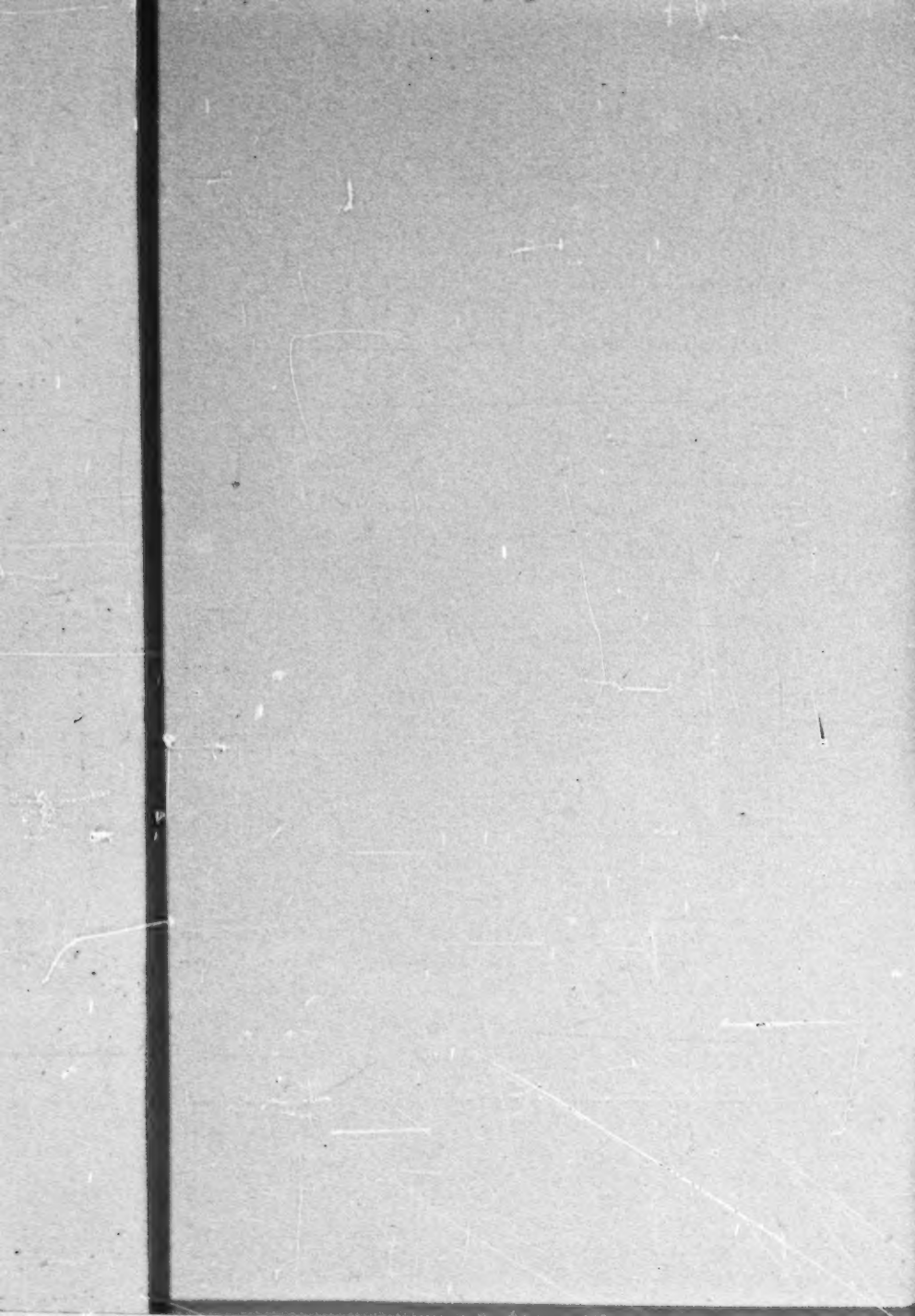
Petition for a Writ of Certiorari to the
Court of Appeal of the State of California
for the First Appellate District

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August 23, 1972



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In the Supreme Court of the United States

OCTOBER TERM, 1972

No.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

DAVID WARE, et al.,

Respondents.

Petition for a Writ of Certiorari to the Court of Appeal of the State of California for the First Appellate District

The petitioner, Merrill Lynch, Pierce, Fenner & Smith, Inc., respectfully prays that a writ of certiorari issue to review the opinion and order of the Court of Appeal of the State of California for the First Appellate District entered in this proceeding on March 15, 1972.

OPINION BELOW

The opinion of the Court of Appeal is reported at 24 Cal.App.3d 35, 100 Cal.Rptr. 791 (1972), and a copy of the opinion appears as Appendix A hereto. No opinion was rendered by the Superior Court of the State of California, in and for the City and County of San Francisco.

JURISDICTION

The decree of the Court of Appeal for the First Appellate District affirming the order denying arbitration was entered on March 15, 1972. A timely petition for hearing in the California Supreme Court was denied on May 10, 1972.

On August 3, 1972, Mr. Justice Douglas signed an order extending the time for filing this petition for certiorari to and including August 23, 1972. This Court's jurisdiction is invoked under 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

1. Does a state law permitting actions for wages to be maintained without regard to private arbitration agreements offend federal law when it is applied to deny arbitration between an employer and former employee when there exists between them a written arbitration agreement required by the Rules and Constitution of the New York Stock Exchange which are promulgated as part of the federal self-regulatory scheme authorized by Congress in section 6 of the Securities Exchange Act of 1934?

2. Does the application of state antitrust law declaring that any contract by which a person is restrained from engaging in a lawful occupation is void to a provision in a profit-sharing plan of a national securities dealer which provides for forfeiture of vested interests if an employee voluntarily terminates his employment and is employed by a competitor constitute an impermissible burden on interstate commerce where the employer is engaged in interstate commerce in a federally regulated industry generally exempt from the application of federal antitrust laws, where the plan operates in interstate commerce, and where the provision is valid under the laws of other states and the laws of the United States?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

§ 78f. *Registration of national securities exchanges.*

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the

Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents below specified:

(2) Such data as to its organization, rules or procedure, and membership . . .

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange;" . . .

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

California Business & Professions Code

§ 16600. Invalidity of Contracts.

Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

California Labor Code

§ 229. Actions to enforce payment of wages; effect of arbitration agreements.

Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate

STATEMENT OF THE CASE

Respondent, a former employee of Merrill Lynch, filed an action on behalf of himself and other former California employees who had voluntarily terminated employment with petitioner and entered into employment with Merrill Lynch's competitors. He sought declaratory relief and damages, alleging that a provision of Merrill Lynch's profit-sharing plan was invalid under California Business & Professions Code § 16600. The plan provides that an employee who voluntarily terminates his employment and enters into an employment relationship with a competing stockbroker loses his vested interest in the plan. Section 16600 of the Business and Professions Code makes void any contract by which an individual is restrained from engaging in a lawful occupation. (Appendix A, pp. 1-4.)

Merrill Lynch answered and raised various defenses, including a defense that application of California law deprived it of the benefits of due process and equal protection under the laws and Constitution of the United States, that its plan operated on an interstate basis, and that the forfeiture provision was valid under federal and New York law, the latter being a choice-of-law provision in the plan, 1 R. 60. It also petitioned for an order compelling arbitration on the basis of a written agreement between it and its former employee, and all other former employee members of the class. The arbitration agreement is contained in a Form RE 1 of the New York Stock Exchange, of which Merrill Lynch is a member. Rule 345 of the Exchange, promulgated pursuant to section 6 of the Securities Exchange Act of 1934, 15 U.S.C. § 78f, requires registration of all persons employed as registered representatives, as were respondent and his class. Appendix B. Rule 347(b) and the Constitution of the Exchange, also promulgated under the same statute, require arbitration of employment disputes between member firms and their employees. Appendix

B. These points were raised in the trial court in a memorandum in support of the petition to compel arbitration and in a reply memorandum to respondent's opposition. 1 R. 135-37. Respondent opposed arbitration on the grounds that no contract existed, that if it did, it was adhesory in nature, and that, in any event, since section 16600 made the forfeiture provision illegal, he could not be required to arbitrate an illegal subject matter under California law. He also moved to determine the action be maintained as a class action. No factual disputes existed which are relevant to this petition. The trial court, by minute order, granted the class action motion and denied the petition to compel arbitration. 1 R. 194. It did not state any ground for the latter action even though requested to make findings of fact and conclusions of law. 1 R. 201. Merrill Lynch appealed that order.

On appeal, and without benefit of findings of fact or conclusions of law, Merrill Lynch challenged the order on all possible grounds, both state and federal. 2 R., Exhibit A. With respect to federal grounds, it contended that the self-regulatory scheme imposed by federal law in the Securities Exchange Act of 1934, including its delegation of authority to the Exchange and the Exchange's promulgation of the arbitration rule, was paramount to the exclusion of state law, 2 R., Exhibit A, pp. 33-35, 50, that state antitrust law could not be applied where interstate commerce was affected, 2 R., Exhibit G, pp. 51-55, and that federal comity required state law to yield to federal supremacy in the antitrust and securities areas in order to achieve equitable and uniform application of federal arbitration policies, 2 R., Exhibit A, p. 55.

On appeal the former employee for the first time asserted the bar of Labor Code § 229. 2 R., Exhibit B, pp. 30-31. After argument the court requested additional briefing, 2 R., Exhibit D, including the application of Labor Code

§ 229. Merrill Lynch referred the court to its brief filed in the companion case¹ as to the latter point. 2 R., Exhibit E.

The Court of Appeal, although agreeing a valid arbitration contract existed, rejected these contentions without discussion, and relied primarily on Business & Professions Code § 16600 and California Labor Code § 229 which provides that actions for wages—the court equated profit-sharing benefits with wages—can be maintained without regard to arbitration agreements, Appendix 10-14. It affirmed the order of the trial court and remitted the action for trial.

These contentions were again raised in a timely petition for hearing in the California Supreme Court. 2 R., Exhibit G. In addition, Merrill Lynch asserted that “the same supremacy required of section 301 [29 U.S.C. § 185(a)] of the Labor Management Relations Act . . . ought to prevail to the exclusion of the applicability of Labor Code § 229.” 2 R., Exhibit G, pp. 4-12. The California Supreme Court refused to hear these contentions. 2 R., Exhibit I.²

REASONS FOR GRANTING THE WRIT

1. The Decision Below Undermines the Congressional Policy of Self-Regulation Contained in the Securities Exchange Act of 1934.

The securities industry, like industrial labor, is highly regulated. In addition to direct legislation, Congress created federal regulation through a federal regulatory agency, the Securities and Exchange Commission, and

1. Some five months earlier the same division of the Court of Appeal had reversed an identical order denying arbitration in an action brought by another employee against petitioner. *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal.App.3d 668, 97 Cal.Rptr. 811 (1st Dist. 1971). Appendix C. The facts are identical and that employee, ostensibly a member of the class here, was ordered to arbitrate. Labor Code § 229 was also raised on appeal there but not applied nor discussed in the court's opinion.

2. It also refused to resolve the direct conflict in opinions of the same Court of Appeal. See note 1, *supra*.

established a statutory scheme of supervised self regulation by stock exchanges, such as the New York Stock Exchange. Section 6 of the Securities Exchange Act of 1934, 15 U.S.C. § 78f, requires registration of national securities exchanges, and the enforcement of rules and by-laws promulgated by them. This self regulatory aspect of the securities industry, carried out by the New York Stock Exchange, is of utmost importance to the fulfillment of the statutory scheme of self-regulation.

The exchanges have responded to the self-regulatory scheme by promulgating rules under section 6 governing the conduct of member firms, such as Merrill Lynch, and employees of member firms, such as respondent. In accordance with this policy of self-regulation, rule 345 of the New York Stock Exchange requires the registration and approval of any person employed by a member firm in the capacity of a registered representative. Appendix B. In consideration of that employment and registration, Rule 347(b) requires all disputes arising out of that employment relationship or its termination be arbitrated. *Ibid.* These, and other substantial regulations are all incorporated in the RE-1 Form. 1 R. 64-67. The purpose of the rules is to insure compliance with the Congressional directive that such rules be "just and adequate to insure fair dealing and to protect investors. . . ." 15 U.S.C. § 78f(d). Rules and regulations which impose stringent obligations on member firms' employees dealing directly with the public are designed to effectuate that purpose. The arbitration rules, like other rules of conduct for member firms and their employees, are an integral part of industry self-regulation which Congress sought to achieve, and do not derogate from the principle of insuring fair dealing to protect investors.

The application of California Labor Code § 229 defeats that very objective and renders the Exchange rules a nul-

lity. The court below did not disagree that the RE-1 form constituted an otherwise valid and binding arbitration agreement. Appendix A, p. 6. It did, however, refuse to give effect to it although arbitration has consistently been the remedy enforced by federal courts in disputes between member firms, e.g., *Brown v. Gilligan, Will & Co.*, 287 F.Supp. 776 (S.D.N.Y. 1968), between member firms and non-member firms, e.g., *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971), and between member firms and employees, e.g., *Dickstein v. DuPont*, 443 F.2d 783 (1st Cir. 1971). The court here, Appendix p. 9, paraphrased the *Dickstein* rationale, 443 F.2d at 783, but refused to apply the arbitration rule of the Exchange even though it bore the implied approval of federal law.

The result reached here has an analogy to federal labor law. In that context, where an employer is engaged in interstate commerce, the issue of arbitrability of a dispute must be resolved by application of federal substantive law fashioned by federal courts under section 301 of the Labor Management Relations Act, 29 U.S.C. § 185(a), *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957). In such a case "incompatible doctrines of local law must give way to principles of federal labor law," *Local 174 Teamsters, etc. v. Lucas Flour Co.*, 369 U.S. 95, 98 (1962). The opinion here is in conflict with that doctrine. The principles of federal securities law require arbitration even in the face of more substantive statutes (i.e., federal antitrust laws) than Labor Code § 229, e.g., *Dickstein v. DuPont*, *supra*. The purpose of arbitration is to keep disputes out of court, a purpose entirely consistent with the self-regulatory grant. Compare *Coenen v. R. W. Pressprich Co.*, 453 F.2d 1209, 1212 (2d Cir. 1972).

Although the Securities Exchange Act of 1934 does not itself command arbitration as does the Labor Management Relations Act, Congress expressly authorized national securities exchanges to promulgate rules and regulations

in accordance with the Act. By such authorization, and by the adoption of such rules to effectuate the self-regulatory grant, the arbitration rules of the Exchange, embodied in the agreement between Merrill Lynch and its employee have the same force and effect as federal law and must be followed.

Self-regulation is thwarted by the possibility that arbitration may or may not be permitted under the laws of different states. Here, for example, New York law contains provisions relating to wages but no law comparable to California Labor Code § 229, *e.g.*, New York Labor Law § 198 (McKinney 1971 Supp.) Thus, the Exchange rule is entirely consistent with 15 U.S.C. § 78F(c). The possibility of conflicting interpretation, as here, may stimulate judicial disputes and impede resolution of conflicts by other means. Lack of uniform treatment makes the need for uniformity in this area particularly compelling. Such uniformity can only come by permitting the self-regulatory arbitration provisions of the Exchange to prevail over inconsistent local laws and thereby fulfill the Congressional objectives.

2. The Decision Below Presents an Important Question of Whether a State Antitrust Law or Non-Arbitration Law May Be Applied Where in Similar Situations, Because of the Pre-emptive Nature of the Self-Regulation Purposes of the Federal Securities Laws, Federal Courts Have Refused to Apply Federal Antitrust Laws to Rules of Exchanges and Their Members.

Where a regulation or rule of a national stock exchange is an instance of self-regulation falling within the scope and purpose of the Congressional purpose in the federal securities law, no action founded on alleged federal anti-trust laws, or to avoid arbitration, is allowed since to do so derogates from the purpose and effectiveness of self-regulation, *e.g.*, *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963); *Dickstein v. DuPont*, 343 F.2d 783 (1st

Cir. 1971). Since federal antitrust law is to a certain extent subservient to the self-regulatory provisions of the Exchange, state antitrust law should be also. And even if the alleged antitrust violation is not the type immunized by self-regulation, *e.g.*, *Silver v. New York Stock Exchange*, *supra* at 371 n. 5 (Mr. Justice Stewart dissenting), that does not affect the fact that the preemptive nature of federal securities laws requires that the arbitration rules be enforced.

Federal courts have consistently upheld these arbitration rules in the face of challenges under federal antitrust laws to the conduct or acts or rules sought to be arbitrated, *e.g.*, *Coenen v. R. W. Pressprich Co.*, *supra* at 1211. *Coenen*, the most recent federal decision on point, summarizes that federal policy and the cases articulating it. *Coenen* involved the issue of arbitration under the Exchange Constitution and rules where a claim was made that the challenged conduct violated the federal antitrust laws. Relying upon the liberal arbitration policies and the purposes of the arbitration rules, the court concluded that these policies were entirely consistent with the Congressional grant to the Exchange.

If federal antitrust law cannot overcome the federal policy of self-regulation, neither can similar state laws. Certainly it is inconsistent to permit that federal policy to override other federal laws but not state laws such as Labor Code § 229 or Business & Professions Code § 16600. To rely on state law and refuse arbitration, as the court did here, frustrates the policy by making Merrill Lynch and its employees settle their disputes in court. It does not frustrate the overall feature of the securities laws which are designed to protect investors. On the contrary this dispute is between a member and its employees. It is, in this context, very similar to disputes between members, since it involves the business conduct of member firms on an internal basis, as distinguished from the conduct of a member

vis-a-vis a public investor. *Cf. Wilko v. Swan*, 346 U.S. 427 (1953). Moreover, it is a rule which lies at the heart of the registration process designed to screen those employees of member firms dealing with the public to insure the required protection of the investor.

The arbitration rule is precisely the kind of self-regulatory provision called for in the 1934 Act. It clearly furthers the Act, as has been recognized in those federal cases in which similar issues are raised. Whether or not, given that federal policy, a state law should be permitted to defeat that aspect of self-regulation, is an important issue which calls for resolution. It affects not only Merrill Lynch, but all member firms of national securities exchanges in the resolution of claims by their employees arising out of that employment relationship.

3. The Decision Below Failed to Give Recognition to Settled Principles of Law Prohibiting Application of State Antitrust Laws to Activities in Interstate Commerce Particularly Where Those Same Acts Do Not Constitute Federal Antitrust Violations and Uniformity of Application Is Desirable and Equitable.

The court below, relying on a decision of the California Supreme Court holding a similar provision in a pension plan to violate the state antitrust laws, *Muggill v. Reuben Donnelley Corp.*, 62 Cal.2d 239, 42 Cal. Rptr. 107 (1965), held the Merrill Lynch provision invalid. That holding is an unwarranted application of state law. This past Term this Court summarily indicated its approval of a long-standing rule of law that state antitrust laws cannot be applied where they are in conflict with federal policy, where national uniformity is required and where the state's regulatory interest is outweighed by the burden on interstate commerce, *Flood v. Kuhn*, ... U.S. ..., ..., 92 S.Ct. 2099, 2113 (1972). Flood had challenged baseball's reserve clause not only on the basis of federal antitrust law but on various states' laws including the very section here in question, *Flood v. Kuhn*, 316 F.Supp. 271, 272 (S.D.N.Y. 1970).

The following facts succinctly point out the need for uniformity here:

1. Merrill Lynch's profit sharing plan operates on a national and international level, open to all eligible employees of Merrill Lynch wherever located, 1 R. 59-60;

2. Except for California, Michigan and Virginia, those states which have considered the legality of a similar provision under state antitrust laws, have found it *not* to be in violation of those laws. *See* ANNOT., 18 A.L.R.3d 1246 (1968);

3. Respondent here, although alleging he was restrained from entering into competition, in fact, was not since the clause only applies to employees who actually are employed by a Merrill Lynch competitor. 1 R. 4;

4. Merrill Lynch employees are engaged in interstate commerce and their activities affect interstate commerce and contemplate use of the facilities of interstate commerce;

5. Similar provisions do not constitute violations of the federal antitrust laws, *e.g.*, *Austin v. House of Vision*, 404 F.2d 401 (7th Cir. 1969).

The employment was interstate in nature, as is Merrill Lynch's business. As such it is susceptible to differing state regulation that, as applied here, requires it to comply with the strictest standard in order to continue its plan in present form. The thrust of the court's decision is that Merrill Lynch may still have a uniform plan, but only if it complies with the laws of California.

Such a uniform plan, based on California law, deprives Merrill Lynch of the benefits of the laws of the far greater number of states in which the provision is legal and of the right to insist that its personnel who have access to confidential business information or who develop close relation-

ships with customers will not utilize such information or relationships in competition with Merrill Lynch.

The court's decision can be construed as giving Merrill Lynch the alternative of maintaining two plans, one for California and one for the rest of its personnel, national and international. Such a bifurcated plan, aside from any inefficient business considerations, presents the risk to Merrill Lynch, and its employees or former employees such as respondent, of losing favorable tax advantages. The Merrill Lynch plan is qualified under federal tax laws, giving thereby certain favorable tax treatment to Merrill Lynch and its employees. This federal qualification can be lost if the plan discriminates in favor of key management personnel. 26 U.S.C. § 401(a)(4). Forfeitures under the provision in question would increase the vested interests of key management personnel at the expense of non-California employees, arguably resulting in the discrimination forbidden by the federal tax laws.

The character of the plan requires that there be uniformity because it does not admit of diversity of treatment. The extraterritorial effect of application here results in an impermissible burden on interstate commerce. The court indicated Business & Professions Code § 16600 constituted a "strong public policy." Appendix A, p. 10. Whether or not that articulated interest should apply to overcome the desired and equitable uniformity required presents an important legal question for resolution.

4. Resolution of the Issues in This Case is Important to a Substantial Segment of American Society.

That the issues have a significance transcending the interests of the parties is apparent from the litigation it has spawned. In California, identical lawsuits have been filed against Reynolds & Co., Goodbody & Co., Glore, For-

gan, DuPont & Co., and Harris Upham & Co. who have similar provisions in their profit-sharing plans. Communications have been received from corporate counsel both within and without the state of California concerning the decision below. The importance to the nationwide securities industry is apparent and is an additional basis for granting the writ.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the order and opinion of the Court of Appeal for the First Appellate District.

Respectfully submitted,

W. REECE BADER

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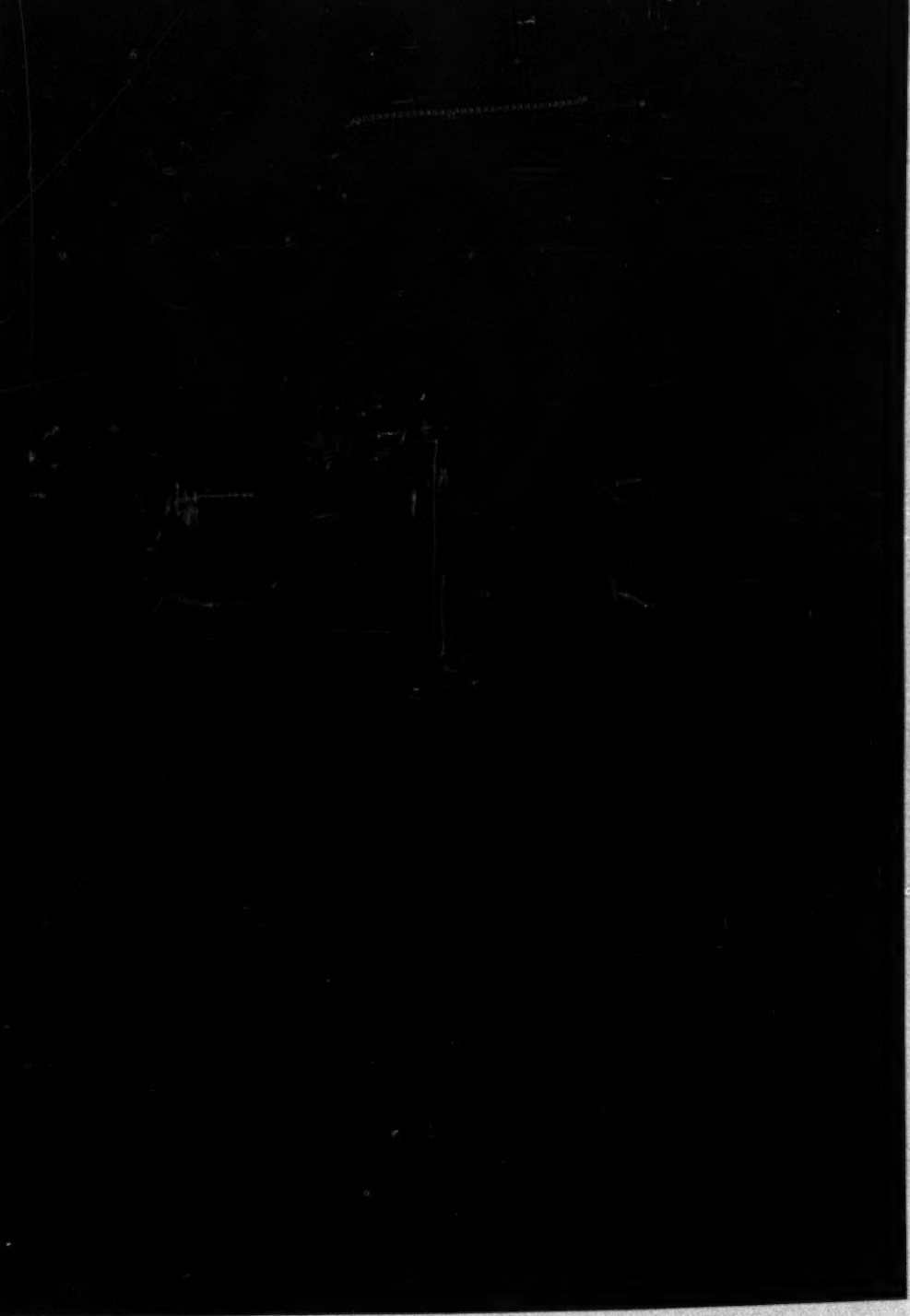
ORRICK, HERRINGTON, ROWLEY & SUTCLIFFE
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San Francisco, CA 94104

Of Counsel for Petitioner

August 23, 1972.

(Appendices Follow)



Appendix A

In the Court of Appeal of the State of California

First Appellate District, Division Four

Filed—Mar 15 1972

1 Civil 28875

(Sup.Ct.No. 612278)

David Ware, on behalf of himself and all
others similarly situated,

Plaintiff and Respondent,

vs.

Merrill Lynch, Pierce, Fenner & Smith,
Inc., a corporation,

Defendant and Appellant.

Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc. appeals, pursuant to Code of Civil Procedure section 1294, subdivision (a), from order denying petition to order arbitration.

Questions Presented

1. Was there an arbitration agreement?
2. Is the forfeiture provision of the arbitration agreement legal?
3. Does Labor Code section 229 prohibit arbitration in this dispute?

Record

Plaintiff, a former employee of Merrill Lynch, Pierce, Fenner & Smith, Inc. (hereinafter Merrill Lynch), on behalf of himself and other former employees similarly situated, filed this action for declaratory relief and damages.

The gravamen of the complaint involves a provision, Article 11.1, in the Merrill Lynch Profit Sharing Plan for Employees. The complaint seeks (1) a declaration that Article 11.1 is invalid under applicable law (Bus. & Prof. Code, § 16600), and (2) that defendant is obligated to pay to plaintiff the amount of the profit sharing rights which Merrill Lynch claims were forfeited and to which plaintiff claims to be entitled. Merrill Lynch answered and filed a petition for order of arbitration. Plaintiff then filed a motion for order determining that the action is maintainable as a class action, and filed affidavits in support of five individuals moving to have themselves made parties of record as members of the class. The petition for arbitration was denied. The motion for class action and to admit the five persons submitting affidavits as plaintiffs was granted. Merrill Lynch appeals from the order denying arbitration.

Facts

In July 1958 plaintiff Ware became an employee of Merrill Lynch at its San Francisco office as an account executive, remaining such until March 1969 when he voluntarily terminated his employment. He then became an employee of another securities broker, competitive with Merrill Lynch. As a full-time employee of Merrill Lynch he was eligible to participate in its profit sharing plan. From time to time Merrill Lynch made contributions to this plan (employees did not contribute) which were credited to plaintiff's account in the profit sharing trust fund. At the termination of his employment plaintiff's account in the fund was credited with 733 vested units and 1,258 unvested units. When plaintiff became eligible to participate in the plan he was given an explanatory brochure and a copy of the plan.

Article 11.1 of the plan provides:

"A participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation . . . and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation . . . shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960." On April 18, 1969 the Administrative Committee of the plan made a determination that plaintiff had voluntarily terminated his employment with Merrill Lynch and had entered into competitive employment. The committee thereupon caused to be forfeited any and all rights plaintiff had in the plan.

Merrill Lynch is a member of the New York Stock Exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. § 78f) which act authorizes the enforcement of rules and bylaws promulgated by said exchange.

Rule 345 of the exchange requires the registration and approval by the exchange of any person employed by a member in the capacity of a registered representative. Plaintiff executed a written application for approval of employment on Form RE-1 of the exchange and was approved and registered. Paragraph 30j of the RE-1 form executed by plaintiff states:

"I agree that any controversy between me and any . . . member organization arising out of my employment on the termination of my employment by and with such . . . member organization shall be settled by arbitration at the instance of any such party in accordance with the Constitution and rules then obtaining of the New York Stock Exchange."

Defendant alleged in its petition for arbitration that all members of the class were subject to the above arbitration provision since each had individually executed the RE-1 form. This is not denied. Plaintiff contends that a class action cannot be arbitrated. Defendant claims that it is not trying to arbitrate a class action but seeking to arbitrate the dispute with the representative of the class under an agreement that also applies to all other members of the class as each has signed a similar agreement. Defendant's contention in this regard is well answered in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal. App. 3d 668, 672, where the identical contract was attacked by a former employee of Merrill Lynch: "Respondent asserts that because he brought his action in behalf of the class of persons affected by the contract arbitration should not be required. But if all employees similarly situated have signed the same arbitration agreement as that which respondent challenges, all are equally bound. If the agreement is valid, it is valid as to all members of the class. It would be inappropriate to allow respondent and the other members of the class he claims to represent to evade the terms of the agreement simply by bringing their action together as a 'class' rather than as individuals."

Section 1281.2 of the Code of Civil Procedure provides in relevant part: "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that: (a) The right to compel arbitration has been waived by the petitioner; or (b) Grounds exist for the revocation of the agreement." No contention is made that defendant waived its right to arbitration as stated in paragraph 30j of the RE-1 form.

On the record there is no substantial conflict in the facts. Where, as here, the issue is one of law only, findings of facts are not required. (*Allstate Ins. Co. v. Orlando* (1968) 262 Cal. App. 2d 858, 867.) In *Loscalzo v. Federal Mut. Ins. Co.* (1964) 228 Cal. App. 2d 391, where petition for arbitration was denied without the trial court's indicating the basis for denial, and in *Bianco v. Superior Court* (1968) 265 Cal. App. 2d 126, where petition for arbitration was granted without the court's indicating the basis for such order, it was held that the reviewing court must determine the correctness of the ruling from the record, and in doing so must determine if the record supports any of the contentions of the parties opposing the arbitration. We proceed to make such determination.

Plaintiff opposed the granting of the petition for arbitration on three basic grounds: (1) no written agreement to arbitrate existed; (2) the contract was an adhesive one and therefore revoked; (3) the issue in dispute and the legality of the forfeiture provision cannot be arbitrated.

1. Arbitration agreement.

The written agreement to arbitrate did exist. (See *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20 Cal. App. 3d 668, 671-672.) The RE-1 form expressly referred to the rules and regulations and constitution of the exchange, and contained an express representation by plaintiff to abide by them. At the time the RE-1 form was executed by plaintiff a rule of the exchange (Rule 347(b)) provided for arbitration between members and their employees arising out of the termination of the employment relationship. (2 CCH New York Stock Exchange Guide, par. 2347b.) Moreover, the RE-1 form which plaintiff admitted executing set forth in its entirety the arbitration clause 30j.

Plaintiff's express representation to abide by the exchange rules charged him with the duty of knowing what the rules are. See *Gear v. Webster* (1963) 258 Cal.App.2d 57, where the appellant became a member of an association of realtors whose bylaws required submission to arbitration of controversies between members. "[B]y agreeing to abide by the bylaws appellant was bound to arbitrate her dispute with another member, here, respondent." (258 Cal.App.2d at p. 61.)

In *Larrus v. First National Bank* (1954) 122 Cal.App.2d 884, the plaintiffs opened a bank account and signed signature cards containing a printed statement that they agreed to be governed by the bylaws of the bank. Their attention was not called to the clause in dispute nor were they advised of the bank's rules. The court held the agreement binding. A reasonable person seeking employment in an industry as highly regulated as the securities exchange with knowledge of a registration requirement cannot escape the binding effect of arbitration rules referred to and expressly set forth in the RE-1 form, which he has signed, by claiming lack of knowledge of the rules integrated into the form.

The RE-1 form is a contractual agreement, even though it is headed "Application." In the application plaintiff stated "I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors . . . as the same have been or shall be from time to time amended, and by all the rules and regulations adopted pursuant to the Constitution and by all practices of the Exchange."

The approval and registration by Merrill Lynch made the application a contract between the parties.

In *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20 Cal.App.3d 668, the identical situation arose as

in this case. Frame was a former employee of Merrill Lynch who voluntarily left their employment and entered competitive employment. As did plaintiff here, he filed an action to have the forfeiture provision of his application for employment declared void. The defendant petitioned for an order requiring arbitration of all issues. The petition was denied by the trial court, which action the reviewing court held erroneous. Involved was the identical form of application for employment involved in this action. There, as does plaintiff here, Frame although he admitted signing the application contended that there was no binding agreement between him and Merrill Lynch for arbitration because there was no mutual assent to the arbitration provision as he was unaware of the clause because he did not read it. To this contention the reviewing court answered: "But failure to read a contract before signing is not in itself a reason to refuse its enforcement. (*Oakland Bank of Commerce v. Washington* (1970) 6 Cal.App.3d 793, 800.)" (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, at p. 671; *Frederico v. Frick* (1970) 3 Cal.App.3d 872, 875.)

Just as plaintiff does here, Frame contended that Merrill Lynch was not a party to the agreement. The court said: "Respondent claims that appellant cannot enforce the agreement to arbitrate because appellant was not a party to it. The arbitration agreement was indeed contained not in a contract form but in a New York Stock Exchange form, entitled 'APPLICATION FOR APPROVAL OF EMPLOYMENT OF REGISTERED REPRESENTATIVE.' But the form was an indispensable part of the arrangements by which respondent was employed by appellant. The subject matter of the 'application' was the approval of respondent's employment by appellant, the form was witnessed by an officer of appellant, and investigation and substantiation of the fact assertions in the application were entrusted to

appellant. The application was part of the larger transaction by which appellant and respondent entered into a continuing employment relationship. Therefore, the arbitration provision is not unenforceable because of lack of mutuality." (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, at pp. 671-672.)

2. The legality of the forfeiture clause.

Frame made the same contention in his case as does plaintiff here, concerning clause 1.11: "The profit-sharing plan under which respondent claims benefits contains a provision that an employee who voluntarily terminates his employment and works for a competitor forfeits his rights to benefits under the plan. Respondent contends that the forfeiture provision is unlawful as being in restraint of trade under Business and Professions Code section 16600. In *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d 239, 242 (42 Cal.Rptr. 107, 398 P.2d 147), the court held invalid under section 16600 a closely analogous provision. In *Muggill* a retired employee went to work for a competitor of his former employer; retirement fund benefits were terminated under a clause similar to the one here in question. We are persuaded that, under *Muggill*, the forfeiture provision is ineffective under California law.

"... Business and Professions Code section 16600 explicitly declares that 'every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.' The California Supreme Court in *Muggill v. Reuben H. Donnelley Corp.*, *supra*, 62 Cal.2d 239, at page 242, has on closely similar facts held a forfeiture provision to be invalid. We conclude from the California Supreme Court's treatment of the problem that section 16600 does represent a 'strong public

policy' of this state." (*Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 20 Cal.App.3d at pp. 672, 673.) Thus, it is clear that the forfeiture clause is invalid and cannot be enforced here.

3. Labor Code section 229.

Defendant contends that plaintiff's argument regarding Labor Code section 229 was not presented to the trial court and is newly raised on appeal. Therefore it should not be considered. If considered, defendant submits that it was reversible error by the trial court in failing to prepare mandatory findings of fact and conclusions of law.

Defendant's contention that the effect of Labor Code section 229 cannot be considered on appeal is without merit. A legal theory to sustain a judgment may be considered on appeal even though it was not raised in the trial court, as long as it does not raise factual issues not presented to the trial court. (*Allstate Ins. Co. v. Orlando*, *supra*, 262 Cal. App.2d 858, 867.) Facts sufficient to sustain such theory under Labor Code section 229 were presented to the trial court. Therefore, Labor Code section 229 should be considered in determining the correctness of the trial court's order.

The *Frame* court did not consider the effect of section 229 of the Labor Code on the arbitration agreement. This section provides that "Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained *without regard to the existence of any private agreement to arbitrate.*" (Emphasis added.) Wages are defined in section 200 of the Labor Code as including "all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

No cases have construed section 229 of the Labor Code, but the intent appears quite clear. While the strong public policy of the state favors arbitration (*Federico v. Frick*, *supra*, 3 Cal.App.3d 872, 875), the intent of the statute is to provide in the first instance a judicial forum where there exists a dispute as to wages. Since the intent is clear, the only determination which must be made is whether the profit sharing benefits constitute wages within Labor Code section 200, *supra*. "[P]ursuant to the present day concept of employer-employee relations, the term 'wages' should be deemed to include not only the periodic monetary earnings of the employee but also the other benefits to which he is entitled as a part of his compensation. [Citations.]" (*Wise v. Southern Pac. Co.* (1970) 1 Cal.3d 600, 607.) A bonus, offered as an incentive to attract employees, has been held to be wages. (*Hunter v. Ryan* (1930) 109 Cal.App. 736, 738.) Payments to a health and welfare fund by an employer (*People v. Alves* (1957) 155 Cal.App.2d Supp. 870, 872), payment of insurance premiums by an employer (*Foremost Dairies v. Industrial Acc. Com.* (1965) 237 Cal. App.2d 560, 580), payments to an unemployment insurance fund (*People v. Dennis* (1967) 253 Cal.App.2d Supp. 1075, 1077), and pension plan benefits (*Hunter v. Sparling* (1948) 87 Cal.App.2d 711, 725) are wages within the meaning of the statute. In its legal sense, the word "wage" has been given a broad, general definition so as to include compensation for services rendered without regard to the manner in which such compensation is computed. (*Estate of Holingsworth* (1940) 37 Cal.App.2d 432, 436.)

In the profit sharing plan in question, it is stated that such employee benefits, a voluntary sharing by Merrill Lynch, etc. of its profits with its employees, is intended not only to reward the employees, but also to provide a nest egg for the future. All contributions to the plan are made

by the employer. The employee's share is determined by the ratio that his compensation bears to the compensation of all eligible employees.

The profit sharing plan is clearly an inducement to employees by a plan through which they benefit financially in proportion to their compensation. Consequently, defendant's contributions to the plan should be considered wages within the meaning of Labor Code sections 200 and 299. Therefore, section 229 must apply to plaintiff's claim, giving him the right to bring his claim in court in spite of any agreement to arbitrate.

"Profit sharing ordinarily signifies the participation of employees with their employer in a given share of the profits of an enterprise by reason of their labor" (*Durkee v. Welch* (S.D.Cal. 1931) 49 F.2d 339, 341.)

Section 229 of the Labor Code was adopted in 1959 (Stats. 1959, ch. 1939, § 1, p. 4532). The California Arbitration Act was revised in 1961 (Stats. 1961, ch. 461, § 2, p. 1540 [now included in Code Civ. Proc., §§ 1280-1294.2]). The fact that the Legislature has not seen fit to amend or repeal section 229 in the approximately 11 years since the revision of the Arbitration Act precludes any claim that section 229 is no longer in effect.

There is nothing in the Arbitration Act to indicate that the public policy inherent in section 229, namely that an employee cannot be required to arbitrate a claim for wages, which arbitration might not take place in California, has changed in any respect.

We hold that the forfeiture provision of the agreement is illegal and that arbitration will not lie. It therefore becomes unnecessary to consider the other contentions of the parties.

The only issue before us on this appeal is the validity of the trial court's order denying respondent's petition

for arbitration. Any other issues under the pleadings may of course be considered by the trial court.

It should be pointed out that the order making this a class action limits the plaintiffs to plaintiff Ware, the five persons designated as additional plaintiffs, and residents of California who voluntarily left the employ of Merrill Lynch and entered into employment with competitive firms and who were not paid profit sharing units by reason of Article 11.1.

Order affirmed.

Certified for publication.

BRAY, J.*

We concur:

DEVINE, P. J.

RATTIGAN, J.

*Retired Justice of the Court of Appeal sitting under assignment by the Chairman of the Judicial Council.

New York Stock Exchange Rule 345.

Employees—Registration, Approval, Records, Discipline

Rule 345. (a) No member or member organization shall

(1) permit any person to perform regularly the duties customarily performed by a registered representative, unless such person shall have been registered with and is acceptable to the Exchange, or

(2) employ any registered representative or other person in a nominal position because of the business obtained by such person.

(b) No member corporation shall permit any person to assume the duties of an officer unless such corporation has filed an application with and received the approval of the Exchange.

(c) The Exchange may disapprove the employment of any person.

(d)(1) If the Exchange determines that any employee or prospective employee of a member or member organization (1) has violated any provision of the Constitution or of any rule adopted by the Board of Governors, (2) has violated any of his agreements with the Exchange, (3) has made any misstatement to the Exchange, or (4) has been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange, the Exchange may withhold, suspend or withdraw its approval of his employment by a member or member organization; may fine such employee or prospective employee \$5,000 for each such violation, misstatement, or act or omission for which he has been found guilty; and may direct that he be censured. The Exchange shall disclose publicly withdrawals of approval

or suspensions of employees and former employees. The Exchange may in its discretion, disclose publicly censures and fines, censures or fines. The total of the fines which may be imposed upon any employee or prospective employee at any one time shall not exceed \$25,000 except as provided in Rule 345(e).

(2) An accusation, charging a registered representative, non-registered employee or prospective employee with having committed a violation shall be in writing; it shall specify the charge or offense with reasonable detail and inform the person charged that he is entitled to request an appearance before a panel of the staff of the department bringing the charges. A copy of the charge or charges shall be served upon the person charged by delivering or by mailing it to him at his office address or at his place of residence. The person charged shall have ten days from the date of such service to answer the same, or such further time as the Exchange may deem proper. The answer and request for an appearance shall be in writing, signed by the person charged and filed with the department bringing the charge. A panel composed of three members of the department shall meet to consider the charge or charges. Notice of this hearing shall be sent to the said person charged; he shall be entitled to be present personally to examine and cross-examine all witnesses produced before said panel and also to present such testimony, defense, explanation or witnesses as he may deem proper. If said person charged should decline, refuse or neglect to request a personal appearance at this hearing, the determination of the panel shall be made on the basis of the charges and the written answer, if any, of the person charged. After hearing all witnesses and the person charged, if he desires to be heard, the panel shall determine whether the person charged is guilty of the offense or offenses. Notice of the finding and

the penalty imposed by the Exchange and that such person may require a review by the Board of Governors in accordance with Rule 345(e), shall be mailed to said registered representative, non-registered employee or prospective employee in the manner hereinbefore provided.

(e) Any present or prospective employee of a member or member organization may require a review by the Board of Governors of any determination and penalty made under this Rule by filing with the Secretary of the Exchange a written demand therefor within 20 days after such determination and penalty has been rendered. As a result of any such review the Board may sustain any determination and penalty imposed, may modify or reverse any such determination, and may increase, decrease or eliminate any such penalty, or impose any penalty, as it deems appropriate. The determination and penalty, if any, as approved by the Board following its review shall be final and conclusive.

(f) If any employee of a member or member organization is suspended or expelled from any other securities exchange or any national securities association, or is suspended or barred from being associated with any member of such exchange or association, or is suspended or barred by any governmental securities agency from dealing in securities or being associated with any broker or dealer in securities, the Exchange may in view of such suspension, expulsion or bar, suspend or withdraw its approval of his employment by a member or member organization, but no such suspension by the Exchange shall commence before or expire after the suspension imposed by such other exchange, association or agency, and no such withdrawal of approval shall be imposed by the Exchange unless such employee has been expelled or barred by such other exchange, association or agency. Nothing in this paragraph (f) shall preclude any proceeding against any employee

under Rule 345(d)(2). In any proceeding under this paragraph (f), the method of procedure required by Rule 345(d)(2) shall not apply, but the employee shall be given not less than ten days notice in writing of a hearing before a panel of the staff of the Exchange to determine whether or not the Exchange should suspend or withdraw, as the case may be, its approval of his employment of a member or member organization, as provided herein. At such hearing, the employee shall be afforded an opportunity to explain why it would be inappropriate for the Exchange to suspend or withdraw its approval of his employment, notwithstanding his suspension, expulsion or bar by such other exchange, association or agency. In the event the employee fails or refuses to appear at such hearing, the Exchange may nevertheless determine the matter and suspend or withdraw its approval of his employment as provided herein. Notice of the Exchange's determination and that such person may require a review by the Board of Governors in accordance with Rule 345(e), shall be mailed to such employee in the manner provided in Rule 345(d)(2).

* * *

New York Stock Exchange Rule 345.17

Agreements.—Each prospective registered representative or officer shall sign the following statements:

(a) "I authorize and request any and all of my former employers and any other person to furnish to the Exchange, or any agent acting on its behalf, any information they may have concerning my credit worthiness, character, ability, business activities, general reputation, mode of living and personal characteristics, together with, in the case of former employers, a history of my employment by them and the reasons for the termination thereof. Moreover, I hereby release each such employer and each such other person from

any and all liability of whatsoever nature by reason of furnishing such information to the Exchange or any agent acting on its behalf.

"Further, I recognize that I will be the subject of an investigative consumer report ordered by the Exchange and that I have the right to request complete and accurate disclosure by the Exchange of the nature and scope of the investigation requested.

(b) I authorize the New York Stock Exchange to make available to any prospective employer, or to any Federal, State or Municipal agency, any information it may have concerning me, and I hereby release the New York Stock Exchange from any and all liability of whatsoever nature by reason of furnishing such information.

(c) I agree that the decision of the New York Stock Exchange as to the results, of any examinations it may require me to take will be accepted by me as final, and that I shall be subject to the penalties provided for under Rule 345(c) of the Board of Governors, as from time to time amended, if, in the opinion of the Exchange, I have

(1) violated any provision of the Constitution or of any rule adopted by the Board of Governors;

(2) violated any of my agreements with the Exchange;

(3) made any misstatements to the Exchange; or

(4) been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange.

(d) I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange as the same have been or shall be from time to time amended, and by all rules and regulations adopted pursuant to the Constitution, and by all practices of the Exchange."

Further, each registered representative, in consideration of the Exchange's approving his application, shall sign the following statements:

(A) "That I will not guarantee to my employer or to any other creditor carrying a customer's account, the payment of the debit balance in such account, without the prior written consent of the Exchange.

(B) That I will not guarantee any customer against loss in his account or in any way represent to any customer that I or my employer will guarantee the customer against such losses.

(C) That I will not take or receive, directly or indirectly, a share in the profits of any customer's account, or share in any losses sustained in any such account.

(D) That I will not make a cash or margin transaction or maintain a cash or margin account in securities or commodities, or have any direct or indirect financial interest in such a transaction or account, except with a member organization or with a bank. I understand and agree that no such transaction may be effected and no such account may be maintained without the prior consent of my employer, and that except for Monthly Investment Plan transactions such employer must receive promptly, directly from the carrying member organization or bank, duplicate copies of all confirmations and statements relating to such transactions or account. I further understand and agree that I shall receive no compensation for commissions or profits earned on any transaction or account in which I have a direct or indirect financial interest, except with the approval of my employer and in accordance with the rules of the Exchange.

(E) That I will not rebate, directly or indirectly, to any person, firm or corporation any part of the compensation I receive as a registered employee, and I will not pay such compensation, or any part thereof, directly or indirectly, to any person, firm or corporation, as a

bonus, commission, fee or other consideration for business sought or procured for me or for any member or member organization of the Exchange.

(F) That at any time, upon the request of the Department of Member Firms, or of any Committee or other Department of the New York Stock Exchange, I will appear before such Committee or Department and give evidence upon any subject under investigation by any such Committee or Department, and that I will produce, upon request of the Exchange, all of my records or documents relative to any inquiry being made by the Exchange.

(G) I understand that any changes in compensation in any form, or additional compensation in any form, may be subject to disapproval by the New York Stock Exchange, and that I may not be compensated for business done by or through my employer after the termination of my employment except as may be permitted by the Exchange.

(H) I agree that I will not take, accept, or receive, directly or indirectly, from any person, firm, corporation or association, other than my employer, compensation of any nature, as a bonus, commission, fee, gratuity or other consideration, in connection with any securities, commodities or insurance transaction or transactions, except with the prior written consent of the Exchange.

(I) I will notify my member organization and the Department of Member Firms promptly if, during the tenure of my employment I become the subject of: any investigation or proceeding by any governmental or securities or insurance industry self-regulatory body; a refusal of registration, injunction, censure, suspension, expulsion or other disciplinary action by any governmental or securities or insurance industry self-regulatory body; a major complaint by a customer of a member organization or by a broker-dealer in securities; a disciplinary action by a member organization; any litigation or arbitration alleging my violation of

any agreement with or provision of any securities industry self-regulatory body's constitution, by-laws, or rules or any securities or insurance law or regulation; or any bankruptcy or contempt proceeding, cease and desist order, injunction or civil judgment as party defendant; or any arrest, summons, arraignment, indictment, or conviction for a criminal offense (other than minor traffic violations); or any material allegation that I have conducted myself in a way which may be inconsistent with just and equitable principles of trade, or detrimental to the interest and welfare of the Exchange, or contrary to an established practice of the Exchange; or if I violate any provision of the Exchange Constitution or of any rule adopted by the Board of Governors or of any securities or insurance law or regulation or of any agreement with the Exchange.

(J) I agree that any controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedure prescribed in the Constitution and rules then obtaining of the New York Stock Exchange."

(K) If the Exchange, during the period of 90 days immediately following receipt by the Exchange of written notice of the termination of my employment gives me written notice that the Exchange is making inquiry into any specified matter or matters occurring prior to termination of such employment, I agree that I will thereafter, comply with any request of the Exchange for me to appear and testify, submit records, respond to written requests, attend hearings, and accept disciplinary charges or penalties with respect to the matter or matters specified in such notice in every respect in conformance with the Constitution, Rules and practices of the Exchange in the same manner and to the same extent as required to do if I had remained

an employee. If I refuse to accept such written notice or, having been given such notice, refuse or fail to comply with any such request of the Exchange, I agree that such refusal or failure may, in the discretion of the Exchange, act as a bar to future Exchange approval of my employment until such time as the Exchange has completed investigation into the matter or matters specified in such notice; has determined a penalty, if any, to be imposed against me; and until the penalty, if any, has been carried out.

New York Stock Exchange Rule 347.

Compensation

Rule 347. (a) Pursuant to Section 1 of Article XV of the Constitution [¶ 1701], registered representatives may be compensated as follows:

(1) registered representatives—on a salary or a commission basis,

(2) branch office managers—on a salary or a commission basis: also, with the prior approval of the Exchange, they may receive a percentage of the net profit of the branch office,

(3) a registered representative who is also head of a department of the organization—may, with prior approval of the Exchange, receive a percentage of the net profit of his department, and

(4) bonuses—registered representatives may participate, with the prior approval of the Exchange, in bonus distributions.

(b) Any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of any such party, in accordance with the arbitration procedure prescribed elsewhere in these rules.

Appendix
Appendix C

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed Oct 19 1971

1/Civil 28135
(Sup.Ct.No. P 16598)

Ronald Frame, a former employee of
Merrill Lynch, Pierce, Fenner & Smith In-
corporated, on behalf of himself and all
other former employees similarly situated,
Plaintiff and Respondent,

vs.

Merrill Lynch, Pierce, Fenner & Smith In-
corporated, a corporation,
Defendant and Appellant.

Merrill Lynch, Pierce, Fenner & Smith, Inc. appeals from an order denying its petition for arbitration of issues raised in an action brought by respondent Ronald Frame.

Respondent, a former employee of appellant, commenced an action seeking a determination that a portion of a purported agreement between appellant and respondent, which provides for forfeiture of profit-sharing rights by any employee of appellant who resigns and then engages in competition with appellant, is void as a restraint on competition condemned by Business and Professions Code section 16600. Appellant pleaded as a defense that respondent had executed an agreement to arbitrate any dispute. Concurrently,

appellant petitioned the court for an order requiring arbitration of all issues (see Code Civ. Proc., § 1281.2). The trial court denied appellant's petition for arbitration, upon the determination (made on affidavits) that "there is no binding agreement between Ronald Frame and defendant to arbitrate this controversy." The present appeal followed. We have concluded that it was error to withhold giving effect to the arbitration clause.

We note preliminarily that the order denying arbitration was based on no findings of fact or conclusions of law other than the recital that "there is no binding agreement . . . to arbitrate this controversy." Although Code of Civil Procedure section 1291 might appear to create an absolute requirement of findings to support such an order, it has been held that the requirement of section 1291 must be read as conforming to the general rules governing findings of fact in civil actions. (*Allstate Ins. Co. v. Orlando* (1968) 262 Cal. App.2d 858, 867.) Here neither party requested findings of fact or conclusions of law; therefore the court's failure to make findings was not error. (Code Civ. Proc., § 632.) Therefore, the order denying arbitration is to be upheld if the record supports it on any theory.

It was a condition of respondent's employment that he be approved by the New York Stock Exchange, of which appellant is a member. Respondent admits that he signed a stock exchange application form which contained an agreement to arbitrate "any controversy between me and any member or member organization arising out of my employment or the termination of my employment by and with such member or member organization . . ." Respondent contends that the agreement to arbitrate was unenforceable because there was no mutual assent to that provision. Specifically he contends that he was unaware of the clause because he did not read it. But failure to read a contract before signing

is not in itself a reason to refuse its enforcement. (*Oakland Bank of Commerce v. Washington* (1970) 6 Cal.App.3d 793, 800.)

Respondent claims that appellant cannot enforce the agreement to arbitrate because appellant was not a party to it. The arbitration agreement was indeed contained not in a contract form but in a New York Stock Exchange form, entitled "APPLICATION FOR APPROVAL OF EMPLOYMENT OF REGISTERED REPRESENTATIVE." But the form was an indispensable part of the arrangements by which respondent was employed by appellant. The subject matter of the "application" was the approval of respondent's employment by appellant, the form was witnessed by an officer of appellant, and investigation and substantiation of the fact assertions in the application were entrusted to appellant. The application was part of the larger transaction by which appellant and respondent entered into a continuing employment relationship. Therefore, the arbitration provision is not unenforceable because of lack of mutuality.

Respondent next attempts to invoke the doctrine of adhesion contracts to invalidate the arbitration clause. It is true that where the bargaining strength of contracting parties is unequal a contractual provision may be construed to give effect to the reasonable expectations of the weaker party when necessary to avoid injury or unfair imposition which it is shown would be the result of giving literal effect to the terms of the contract. (See Comment (1967) 1 U.S.F. L.Rev. 306.) Here, assuming that the contract was adhesionary, it is not shown that arbitration would be contrary to the reasonable expectations of any party or that any loss or unfair imposition would result. Therefore no basis exists in the present case for using the doctrine of adhesion contracts to avoid arbitration. (*Cf. Federico v. Frick* (1970) 3 Cal. App.3d 872, 875.)

Respondent asserts that because he brought his action in behalf of the class of persons affected by the contract arbitration should not be required. But if all employees similarly situated have signed the same arbitration agreement as that which respondent challenges, all are equally bound. If the agreement is valid, it is valid as to all members of the class. It would be inappropriate to allow respondent and the other members of the class he claims to represent to evade the terms of the agreement simply by bringing their action together as a "class" rather than as individuals.

The profit-sharing plan under which respondent claims benefits contains a provision that an employee who voluntarily terminates his employment and works for a competitor forfeits his right to benefits under the plan.¹ Respondent contends that the forfeiture provision is unlawful as being in restraint of trade under Business and Professions Code section 16600. In *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d 239, 242, the court held invalid under section 16600 a closely analogous provision. In *Muggill* a retired employee went to work for a competitor of his former employer; retirement fund benefits were terminated under a clause similar to the one here in question. We are persuaded that, under *Muggill*, the forfeiture provision is ineffective under California law. Appellant points out, however, that the contract contains an express provision that the rights of the parties will be governed by the law of New York. It is conceded that under New York law the forfeiture provision is valid; it would not be treated as

1. "11.1 A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960."

being in restraint of trade as it would be under California law. (See *Kristi v. Whelan* (1957) 164 N.Y.S.2d 239, aff'd 5 N.Y.2d 807, 809.)

The next question is whether the provision specifying New York law is valid. As a general rule, it is said that contracting parties may by agreement specify what law is to control their contract if "enforcement of the contract by a local court in accordance with the foreign law agreed to be controlling does not result in an evasion of the settled public policy or a statute of the forum protecting its citizens." (11 Cal.Jur.2d, § 55, p. 138.)

We recognize that the choice-of-law question is not foreclosed by the existence of an applicable California statute where New York State has substantial contacts with the transaction and the parties, if no attempt to evade California law appears. But an agreement designating applicable law will not be given effect if it would violate a strong California public policy. (*Ury v. Jewelers Acceptance Corp.* (1964) 227 Cal.App.2d 11, 20; cf. *People v. Globe & Rutgers Fire Ins. Co.* (1950) 96 Cal.App.2d 571, 575 [upholding contract provisions designating applicable law].) Here Business and Professions Code section 16600 explicitly declares that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." The California Supreme Court in *Muggill v. Reuben H. Donnelley Corp.*, *supra*, 62 Cal.2d 239, at 242, has on closely similar facts held a forfeiture provision to be invalid. We conclude from the California Supreme Court's treatment of the problem that section 16600 does represent a "strong public policy" of this state. Therefore the agreement for application of New York law must not be allowed to defeat that policy.

It does not follow, however, that the entire contract was necessarily unlawful. Issues of law and fact may emerge

as to the severability of the unlawful penalty provision. A latent question exists as to whether the agreements of the parties may be construed as applying only to such permissible subjects of restraint as breaches of confidence and misappropriation of trade secrets. Other questions may be raised as to the time and circumstances of respondent's employment and the amount of any benefits earned and remaining unpaid. All of these matters, whether they involve questions of law or questions of fact, are in the first instance properly subject to arbitration. (*In re Frick* (1933) 130 Cal.App. 290, 292.) If the award wrongly gives effect to an unlawful contractual provision, it will be subject to attack on the hearing of any petition for confirmation. (See *Loving & Evans v. Blick* (1949) 33 Cal.2d 603.)

The order denying arbitration is reversed.

CHRISTIAN, J.

We concur:

DEVINE, P. J.

DAVID, J.*

*Assigned by the Chairman of the Judicial Council.



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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,

Petitioner

vs.

DAVID WARE, et al.,

Respondents

**On Petition for a Writ of Certiorari to the Court of Appeal
of the State of California for the First Appellate District**

BRIEF IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeal (App. A of The
Petition) is reported at 24 Cal. App. 3d 35, 100 Cal.
Rptr. 791 (1972). The Supreme Court of the State
of California denied Merrill Lynch's Petition for a
Hearing without comment on May 10, 1972.

JURISDICTION

No basis exists for invoking the jurisdiction of this Court. The reference in the Petition to 28 U.S.C. § 1257(3) is unsupported. The decision of the state court:

1. Did not involve a federal question;
2. Is not final either under California law or the guidelines established by this Court.

This lawsuit was filed in the state court and concerns nothing more than the application of California restraint of trade law to a profit sharing plan of a corporation doing significant business in California. A compendium of similar cases all decided under state law may be found in 18 A.L.R. 3d 1246 (1968), and 81 A.L.R. 2d 1066 (1962).

QUESTIONS PRESENTED

1. Does the application of California restraint of trade law invalidating a forfeiture provision in a profit sharing plan of a national corporation as applied only to the citizens of that state constitute an impermissible burden on interstate commerce

(a) where the profit sharing plan itself was drafted pursuant to the laws of a sister state;

(b) has nothing whatsoever to do with the type of business in which the employer is engaged; and

(c) where the plan itself provides that it is to be construed according to state law?

2. Does state law evincing strong public policy, whereby a lawsuit for wages may be maintained notwithstanding the existence of a private arbitration agreement, involve a substantial federal question when the Petitioner itself invoked the application of the state arbitration processes?

STATUTES INVOLVED

California Business and Professions Code

§16600. *Invalidity of Contracts.* Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

California Labor Code

§229. *Actions to enforce payment of wages; effect of arbitration agreements.* Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate.

...

STATEMENT

This litigation was commenced by a former employee of Petitioner on behalf of himself and all other residents of the State of California who were formerly employed in California by Merrill Lynch and who, by reason of pursuing lawful competitive employment,

were denied distribution of their earned profit sharing credits by reason of Article 11.1 of the Plan.¹

The complaint challenged the forfeiture provision under California unfair competition law, California Business and Professions Code §16600, 1 R. 1-6, 44, charging, in essence, breach of the employment contract and illegality of Article 11.1.

Thereafter, Merrill Lynch filed its answer pursuant to California law, denying the allegations of the complaint, but admitting that it pursued a uniform policy of forfeiture in California as alleged by respondent, 1 R. 51-61.

Merrill Lynch did not seek removal of the action to federal court. 28 U.S.C. 1445, et seq.

Petitioner, in the same action, then filed a petition to compel arbitration and to stay all proceedings pursuant to California's comprehensive arbitration legislation. Code of Civil Procedure §1280-1294.2, et seq., 1 R. 132-138, 149-153.

Petitioner did not assert the applicability of the Federal Arbitration Act, 9 U.S.C. 1, et seq., or of federal arbitration law. 1 R. 75-80, 132-138.

The trial court, by minute order, denied arbitration based solely upon ruling California case law and the

¹ARTICLE 11. *Forfeiture of Benefits.*

11.1 A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960.

state statute interpreted therein. 1 R. 194. A timely appeal was taken by Merrill Lynch and the decision of the trial court was affirmed (Appendix A of the Petition), again on the basis of California law.

It is noteworthy that Petitioner accepted the application of California law in the case of *Frame v. Merrill Lynch*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971) which preceded the instant action on appeal and wherein Article 11.1 of the Plan was declared illegal and void under California law.

Merrill Lynch did not petition for rehearing of the *Frame* decision before the California Court of Appeal, nor did it request a hearing before the California Supreme Court or this Court.

The *Ware* case has been remanded to the trial court for a hearing on the merits. (Appendix A of the Petition, pp. 11-12.)

ARGUMENT

The decision herein does not involve a substantial federal question or, for that matter, a federal question at all. Petitioner strains the limits of legal advocacy by asserting that somehow a wage dispute involving a profit sharing plan comes within the congressional legislation embodied in the Securities Exchange Act of 1934. The fact that Petitioner happens to be involved in the securities business is peripheral to the manner in which it compensates its employees.

To carry Petitioner's argument to its logical conclusion would mean that any time an employee has a

wage dispute with his employer and that employer's business happens to involve the sale of securities or any transaction in interstate commerce, federal courts and, perforce, federal law would be called into play. This Court is simply not a referee of every backyard or neighborhood dispute.

By way of example, workmen's compensation and disability laws differ from state to state regardless of the interstate aspects of the employer's business, yet, this variance has not been viewed as an impermissible burden on interstate commerce.

In point of fact, the profit sharing plan, by its own terms, was drafted under New York law and seeks to employ the laws of that state, 1 R. 47, as to all questions of construction and interpretation.

Petitioner's position, simply stated, is that a compensation plan drafted pursuant to the laws of one state which happens to be favorable should be forced upon the residents of all other states, notwithstanding what the laws of the state of residency and employment provide.

I

THE STATE COURT DECISION DOES NOT INVOLVE A FEDERAL QUESTION

1. The Decision Below does not Involve the Application of State or Federal Antitrust Laws.

It is essential to a review of a state court decision by this Court that an important federal issue be tendered to the state court and, further, that such a

question be, in fact, decided. *Cardinale v. La.*, 394 U.S. 437 (1969). Neither requirement has been met in this case.

This controversy pivots around the interpretation and application of California Business and Professions Code §16600 which (contrary to Petitioner's characterization as an antitrust law) is a legislative adoption of common law principles of restraint of trade. Moreover, California antitrust laws are solely embodied in the Cartwright Act, Business and Professions Code §16700-16758, titled "Combinations in Restraint of Trade." It is §16722 of the Cartwright Act which Petitioner apparently confuses with §16600. That section (16722) provides that "Any contract or agreement in violation of this chapter is absolutely void and is not enforceable at law or in equity."

The complaint does not allege the existence of a monopoly, conspiracy or combination aimed at destroying competition, or any concert of action, whatsoever. These are the ingredients of a claim under either state or federal antitrust laws. *Chas. A. Ramsay & Co. v. Assoc. Billposters*, 260 U.S. 501 (1922); *People v. Santa Clara Valley Bowling Proprietors Assn.*, 238 Cal. App. 2d 225, 47 Cal. Rptr. 570 (1965).

Nor is there a prayer for treble damages.

Agreements involving alleged restraint of trade between an employer and its employee are not circumscribed by antitrust legislation. *Light Corrugated Box Corp. v. Southern Kraft Corp.*, 20 N.Y.S. 2d 66 (1940); *Bondi v. Jewels by Edward, Ltd.*, 267 Cal.

App. 2d 672, 73 Cal. Rptr. 494 (1968); *Austin v. House of Vision*, 404 F. 2d 401 (7th Cir. 1969).

It is anomalous to suggest that in a situation where every member of the class has secured competitive employment in an open market, antitrust laws apply. *Triton Ins. Underwriters, Inc. v. National Chiropractic Ins. Co.*, 232 Cal. App. 2d 829, 833, 43 Cal. Rptr. 504 (1968).

If the complaint had alleged violations of the anti-trust laws, it would, by that fact alone, be exempted from private arbitration agreements. *Assoc. Milk Dealers v. Milk Drivers*, 422 F. 2d 546, 552 (7th Cir. 1970). Matters of public policy are best resolved by judges, not arbitrators.

The application of state law in a securities business context was confirmed in *Gitelson v. duPont*, 268 N. Y. Supp. 2d 11, 215 N.E. 2d 866 (1966), where a former employee sued a member of the New York Stock Exchange to recover pension benefits forfeited and by every state and federal court that has considered the question. See Annot. 18 A.L.R. 3d 1246 (1968) and 81 A.L.R. 2d 1066 (1962).

Likewise, the appellate court in the *Ware* case based its decision solely on California state law without reference whatsoever to federal law, following an unbroken line of cases which have uniformly held such forfeitures invalid in California.

The issue, simply, is one of comity.

"Comity between states does not require a law of one state to be executed in another when it would be against the public policy of the latter state. . .

"The rule of the cases cited is approved by the Supreme Court and other federal courts . . . when the policy of a state by a special law has been made manifest, the courts of the United States will be bound to notice the statute of policy as a part of its code of laws, and to declare all contracts in the state repugnant to it to be illegal and void . . ."

Davis v. Jointless Fire Brick Co., 300 F. 1 (9th Cir. 1924) at pp. 3 and 4.

Comity between the states is a question within the exclusive jurisdiction of the state courts. *Allen v. Alleghany Co.*, 196 U.S. 458 (1905).

The decision by any analysis rests squarely upon an independent and adequate state ground.

2. The Decision Below does not Involve the Application of Federal Securities Law.

As Petitioner recognizes, the intent behind the Securities Exchange Act of 1934 is "... to insure fair dealing and to protect investors ..." 15 U.S.C. 78f(d).

The Act does not apply to situations involving employer-employee relations within the securities industry, *Gitelson v. duPont*, supra, despite the existence of a private arbitration agreement.

No provision of the Securities Exchange Act commands arbitration. 2 R. Exh. G, p. 11. On the contrary, three sections of the Act of 1934 expressly preserve the right of an individual to a judicial forum: 15 U.S.C. 78i(e), 15 U.S.C. 78p(b), and 15 U.S.C. 78r(a).

The Supreme Court, as well as other federal courts, has long recognized that civil litigation is fully compatible with the policies reflected in the federal securities legislation. *Wilko v. Swan*, 346 U.S. 427 (1953); *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Mahen, et al. v. Reynolds & Co.*, 282 F. Supp. 423 (S.D.N.Y. 1967); *Reader v. Hirsch & Co.*, 197 F. Supp. 111 (S.D.N.Y. 1961).

Further, the Act states that no rule or agreement of any exchange shall be construed as a waiver of any constitutional right, such as the right to a court or jury trial. 15 U.S.C. 78f(a)(1).

By necessity, the New York Stock Exchange Constitution, Article VIII, preserves the right of non-member employees to have disputes settled in a courtroom except where the nonmembers, themselves, elect to use arbitration. 2 COH N.Y. Stock Exchange Guide, Para. 1351 (Appendix A). *Axelrod & Co. v. Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D. N.Y. 1970), Affirmed 451 F. 2d 838 (2nd Cir. 1971). Each member of the class in this case is a nonmember of the New York Stock Exchange.

The profit sharing plan, itself, does not refer to the Security Act or federal law.

The right of an individual to all lawfully accrued wages is a matter of significant local interest, and California Labor Code §229 typifies this strong public policy and concern of the State for its citizens. *City of Ukiah v. Fones*, 64 Cal.2d 104, 410 Pac.2d 369 (1966).

In fact, the exceptions carved from the arbitration process by §229 are not unique. The equivalent may be found in federal arbitration law which excludes from its machinery employment contracts of seamen, railroad employees and "any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. §1.

Stockbrokers, as a class, perform work which involves interstate commerce. (Petition, p. 12.) Accordingly, had the petition to arbitrate been tendered under federal law, it would have likewise been denied.

Contrary to the Petitioner's sweeping statements that the California court's decision emasculates the New York Stock Exchange arbitration process, the decision has limited its area of effectiveness to wage disputes. Any other controversy is still subject to arbitration.

II

THE DECISION BELOW IS NOT FINAL

The decision of the California Court of Appeal affirming the trial court's minute order, 1 R. 194, denying the petition for arbitration under state law is not final, either under California law, or the rules fashioned by this Court. "Every direction of a court or judge in a civil action, made or entered in writing, and not included in a judgment, is denominated an order." California Code of Civil Procedure §1003.

Although such an order denying arbitration is specifically made appealable per California Code of

Civil Procedure §1294, nevertheless, it is interlocutory in nature. *Berman v. Renart Sportswear Corp.*, 222 Cal. App. 2d 385, 388, 35 Cal. Rptr. 218 (1963). Interlocutory means, in essence, that something further is left to be determined before a final judgment is entered. *Reed v. Reed*, 9 Cal. App. 748, 752, 100 Pac. 897 (1909).

In point of fact, no judgment has been entered on the pleadings in this case. The dispute has been remanded to the trial court for further proceedings with the following direction:

"Any other issues under the pleadings may, of course, be considered by the trial court." Opinion of the Court, 2 R. Ex. J. p. 14.

According to the criteria established by this Court,

"It (state court decision) must be subject to no further review or correction in any state tribunal; it must, also, be final as an effective determination of the litigation and not of merely interlocutory or intermediate steps therein."

Market Street R. Co. v. Railroad Commission, 324 U.S. 548, 551 (1945).

This same test for determining whether the judgment is final has been adopted by the California Supreme Court. *People v. Succop*, 65 Cal. 2d 483, 486; 421 Pac.2d 405 (1966).

As such, the order denying arbitration has not been stamped with the imprimatur of finality as required by this Court for review. *Baltimore Contractors v. Bodinger*, 348 U.S. 176 (1954).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

JOSEPH C. BARTON,

THOMAS E. FEENEY,

Counsel for Respondents.

FEENEY AND SPARKS,

Of Counsel.

October 2, 1972

(Appendix A Follows)

Appendix A

CONSTITUTION OF THE NEW YORK STOCK EXCHANGE, INC.

Article I

Title—Objects—Definitions

¶ 1001—Title

SEC. 1. The title of this Corporation shall be the "NEW YORK STOCK EXCHANGE, INC."

¶ 1002—Objects

SEC. 2. Its objects and purposes shall be:

(a) to furnish exchange rooms for the convenient transaction of their business by its members; to furnish other facilities for its members, allied members, member firms and member corporations; to maintain high standards of commercial honor and integrity among its members, allied members, member firms and member corporations; and to promote and inculcate just and equitable principles of trade and business;

(b) to conduct and carry on the functions of a "board of trade" within the meaning of that term in the New York Not-for-Profit Corporation Law;

(c) to conduct and carry on the functions of an "exchange" within the meaning of that term in the Securities Exchange Act of 1934; and

(d) to conduct and carry on any and all activities incidental to the foregoing which may lawfully be conducted and carried on by a corporation of its type formed under the New York Not-for-Profit Corporation Law.

§ 1005—Definitions

Sec. 3. Unless the context requires otherwise, the terms defined in this Section shall, for all purposes of the Constitution, have the meanings herein specified:

Member

(a) The term "member" means a member of the Exchange, and does not include within its meaning an allied member of the Exchange.

Membership

(b) The term "membership" refers to the members of the Exchange, and does not refer to the allied members.

Member firm

(c) The term "member firm" means a firm, transacting business as a broker or a dealer in securities, at least one of whose general partners is a member of the Exchange or which has the status of a member firm by virtue of permission given to it by the Board of Governors pursuant to the provisions of Section 13(a) of Article IX.

Allied member

(d) The term "allied member" means:

(i) a general partner in a member firm who is not a member of the Exchange and who has become an allied member as provided in Article IX, or

(ii) an employee of a member corporation who is actively engaged in its business and devotes the major portion of his time thereto, who is not a member of the Exchange, who has become an allied member as provided in Article IX, and who is either:

(a) a director and a holder of record and beneficial owner of voting stock of such corporation, or

(b) a principal executive officer and a holder of record and beneficial owner of voting stock of such corporation, or

(c) a holder of record and beneficial owner of 5% or more of the outstanding voting stock of such corporation.

Non-member

(e) The term "non-member" means a party not a member, allied member, member firm or member corporation.

Member corporation

(f) The term "member corporation" means a corporation, transacting business as a broker or dealer in securities, approved by the Board of Governors as a member corporation, having at least one member of the Exchange who is a director thereof and a holder of voting stock therein. A corporation shall cease to be a member corporation if the approval of the Board of Governors is withdrawn or if it shall cease to transact business as a broker or dealer in securities or to have a member of the Exchange as a director thereof and holder of voting stock therein, unless the

corporation has the status of a member corporation by virtue of permission given to it by the Board of Governors pursuant to the provisions of Section 13 (b) of Article IX.

Approved person

(g) The term "approved person" means a party who is not an employee, a member or an allied member of a member corporation, who has become an approved person as provided in Article IX, and who is a director of a member corporation, or who beneficially owns 5% or more of the outstanding voting stock of a member corporation.

Freely transferable security

(h) The term "freely transferable security" means (i) any stock which on its face may be transferred without it being necessary that the Exchange approve the transferee, and (ii) any debt instrument which on its face may be transferred without it being necessary that the Exchange approve the transferee and which evidences a liability subordinated to general creditors as approved by the Exchange.

Voting stock

(i) The term "voting stock" means stock in a corporation the holders of which are entitled to vote for the election of the directors of such corporation.

Non-voting stock

(j) The term "non-voting stock" means stock of any class in a corporation other than voting stock.

(k) The term "entire Board" means the total number of Governors which the Exchange would have if there were no vacancies.

When a meeting is adjourned to another time or place, it shall not be necessary to give any notice of the adjourned meeting, if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken, and at the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting.

¶ 1313—Presiding Officer

SEC. 13. At any meeting of the members of the Exchange, if neither the Chairman of the Board nor the Vice Chairman of the Board nor a member of the Board of Governors authorized to act for the Chairman of the Board under Section 2 of Article V shall be present, the members present, in person and by proxy, shall appoint a presiding officer for the meeting.

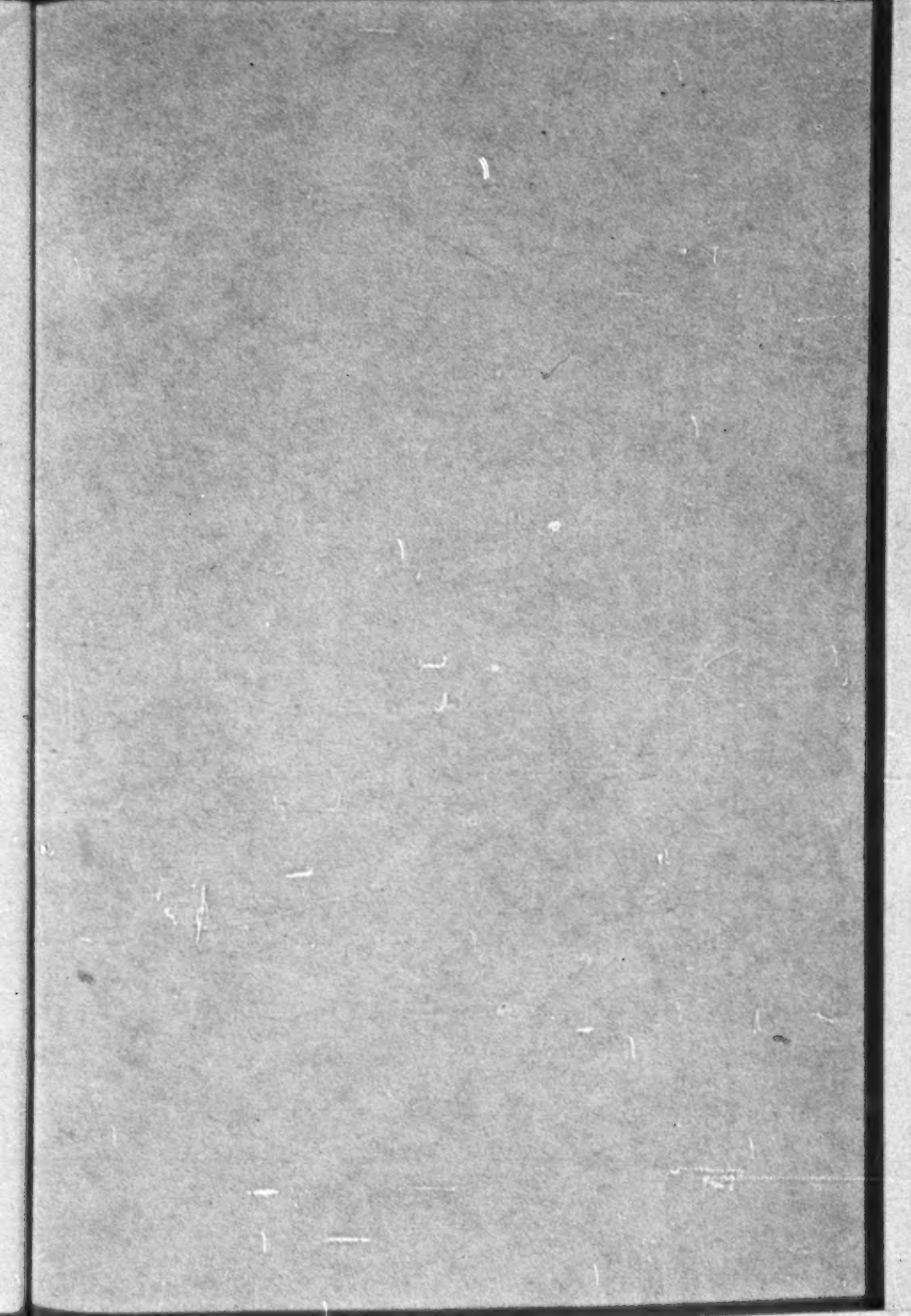
Article VIII

Arbitration

¶ 1351—Controversies Arbitrated

SEC. 1. Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such mem-

ber, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Governors.



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No. 72-312

In the Supreme Court of the United States

OCTOBER TERM, 1972

**MERRILL LYNCH, PIERCE, FENNER & SMITH,
PETITIONER**

v.

DAVID WARE, ET AL, RESPONDENTS

**ON PETITION FOR A WRIT OF HABEAS CORPUS TO THE COURT OF
APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST
APPELLATE DISTRICT**

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH,
PETITIONER

v.

DAVID WARE, *et al.* RESPONDENTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF
APPEAL OF THE STATE OF CALIFORNIA FOR THE FIRST
APPELLATE DISTRICT

MEMORANDUM FOR THE UNITED STATES AS AMICUS CURIAE

This memorandum is filed in response to the Court's order of November 18, 1972, inviting the Solicitor General to express the views of the United States in this case.

STATEMENT

Petitioner, Merrill Lynch, Pierce, Fenner & Smith, Inc., is a member organization of the New York Stock Exchange. It has a profit-sharing plan for employees, which provides that an employee who voluntarily terminates his employment and engages in an occupation competitive with Merrill Lynch forfeits his vested interest in the plan (Pet. App. 3). Respondent

is a former account executive of Merrill Lynch, employed in California, who voluntarily terminated his employment with that firm and became an employee of a competing securities broker. He initiated this suit in a state court in California, seeking his accrued share of the profit-sharing rights, which Merrill Lynch claimed to have been forfeited. He contended that the forfeiture provision was invalid under California Business and Professions Code 16600, which makes void any contract to the extent that it restrains an individual from engaging in a lawful occupation (Pet. App. 2).¹

After answering, Merrill Lynch petitioned for an order compelling arbitration and staying the proceeding. It relied on a New York Stock Exchange form signed by Mr. Ware which provided, in conformity with NYSE Rule 345 (Pet. App. 13), for approval by the Exchange of his employment as a registered representative of Merrill Lynch. In this form he agreed to abide by the Constitution and Rules of the Exchange (Pet. App. 17), including Rule 347(b), which requires that any controversy between an employee and a member organization arising out of employment or its termination be settled by arbitration (Pet. App. 20, 21, 22).

The trial court denied Merrill Lynch's petition without opinion (Pet. 1), and Merrill Lynch appealed.

¹ California Business and Professions Code 16600, provides, in pertinent part:

"* * * every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

The California Court of Appeal sustained the trial court's action, holding: (1) that there was a valid contract between Merrill Lynch and Ware to arbitrate this dispute; (2) that the forfeiture provision of the Merrill Lynch plan was an unlawful restraint of trade under California Business and Professions Code 16600 and that it was thus unenforceable in California; and (3) that Ware's action was a suit for "wages" and thus could be maintained under California Labor Code 229² without regard to the arbitration agreement (Pet. App. 5-11). The court's opinion also authorized the trial court to consider other issues raised by the pleadings prior to entry of judgment (Pet. App. 12). Subsequently, the California Supreme Court denied Merrill Lynch's timely petition for a hearing (Pet. 1).

DISCUSSION

The government believes that no question is presented warranting review by this Court. The court of appeal's decision does not conflict with federal policy governing arbitration of employment disputes; the application to this case of *Silver v. New York Stock Exchange*, 373 U.S. 341, is not properly presented on this record; and the application of the California law

² California Labor Code 229, provides:

"Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement."

against restraints on engaging in a lawful business does not burden interstate commerce.³

1. Merrill Lynch points out, as it did below, that the securities industry is regulated. The Securities Exchange Act of 1934 subjects the industry to regulatory oversight by the Securities and Exchange Commission and provides for supervised self-regulation by exchanges such as the New York Stock Exchange ("the Exchange"). The Exchange has promulgated rules pursuant to Section 6 of the Securities Exchange Act, 15 U.S.C. 78f, by which respondent agreed to abide. Because the Exchange has provided for compulsory arbitration of disputes between member firms and their employees, Merrill Lynch relies on the federal policy, expressed most clearly in Section 301 of the Labor Management Relations Act, 29 U.S.C. 185(a), favoring arbitration of labor-management disputes. See *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448.

³ There is also, as respondent contends, a substantial argument that the state court's decree is not "final" under 28 U.S.C. 1257. In *Baltimore Contractors, Inc. v. Bodinger*, 348 U.S. 176, a diversity suit for an accounting of profits, this Court stated that a district judge's order denying a stay of action pending arbitration because there was no valid agreement between the parties to arbitrate was not a "final decision" appealable to the court of appeals under 28 U.S.C. 1291. See also *Sand Springs Home v. Naharkey*, 299 U.S. 588 (state court judgment ruling on question otherwise reviewable by this Court held not final because it also directed a remand for an account upon which a further decree was to be entered); *Grays Harbor Logging Co. v. Coats-Fordney Co.*, 243 U.S. 251 (state court judgment that a taking by eminent domain was for a public use held not "final" under a predecessor to 28 U.S.C. 1257, where the amount of compensation had not yet been determined).

The federal policy favoring arbitration reflected in Section 301 of the Labor Management Relations Act is not applicable here. That statute applies only to questions arising under collective bargaining agreements. Respondent's profit-sharing rights flowed not from such an agreement but from an individual contract with Merrill Lynch. Moreover, Section 229 of the California Labor Code is by its terms inapplicable to "claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement." See n. 2, *supra*. A similar exemption is expressed in the Federal Arbitration Act, which is inapplicable to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in * * * commerce." 9 U.S.C. 1.

In any event, cases concerning both commercial and labor arbitration indicate that where a claimant's legal action is founded essentially on a statutory right—as is Ware's claim that under California law he is entitled to his accrued benefits under the profit-sharing plan—the right to sue is not defeated by an agreement to arbitrate. Thus, in *Wilko v. Swan*, 346 U.S. 427, this Court allowed a purchaser of securities to bring a damage suit under the Securities Act of 1933, despite an arbitration provision in the margin agreement. Although acknowledging "the desirability of arbitration as an alternative to the complications of litigation," this Court concluded that "the special

* But cf. *Dickstein v. duPont*, 443 F. 2d 780, 785 (C.A. 4), stating that the federal exemption is generally limited to employees engaged in the actual movement of goods in commerce.

right to recover for misrepresentation" afforded by Congress would be diluted by depriving the purchaser of his right to litigate. Similarly, in *Arguelles v. U.S. Bulk Carriers, Inc.*, 400 U.S. 351, a seaman was permitted to litigate under federal statutes providing redress to seamen allegedly denied prompt and proper payment of wages, despite a provision in the applicable collective bargaining agreement for arbitration of such disputes.⁴

Thus, the general federal policy favoring arbitration does not require that Ware be forced to arbitrate his claim based on the California Business and Professions Code.

2. Merrill Lynch argues further that since federal antitrust law is to some extent "subservient to" provisions of the Exchange rules promulgated under the self-regulatory function given national stock ex-

⁴ See also *McKinney v. Missouri-K.T.R. Co.*, 357 U.S. 265, 268 (returning servicemen not obliged to pursue remedies available under the grievance procedure set forth in the collective bargaining agreement before bringing a court action under Section 9(d) of the Universal Military Training and Service Act); *Thompson v. Iowa Beef Packers, Inc.*, 185 N.W. 2d 738 (S. Ct. of Iowa), certiorari dismissed as improvidently granted, 405 U.S. 228 (employees not obliged to exhaust grievance-arbitration procedures of the collective bargaining agreement before bringing a court suit under Section 16(b) of the Fair Labor Standards Act to recover overtime compensation due under that Act). Compare *Republic Steel Corp. v. Maddox*, 379 U.S. 650 (requiring arbitration where employee, bypassing contractual grievance procedure, sued employer in state court to collective severance pay pursuant to the collective agreement); *Dickstein v. duPont*, 443 F. 2d 783 (C.A. 1) (employee forced to arbitrate contract claim), discussed *infra*, pp. 12-13.

changes under the Securities Exchange Act of 1934, state law—such as California Labor Code 229 and California Business and Professions Code 16600—should be similarly subservient to the Exchange rules. Citing *Silver v. New York Stock Exchange*, 373 U.S. 341, Merrill Lynch urges that refusing arbitration frustrates the federal policy of self-regulation by making member firms and their employees settle their disputes in court; it characterizes the arbitration provisions as lying “at the heart of the registration process designed to screen those employees of member firms dealing with the public” and as “precisely the kind of self-regulatory provision called for in the 1934 Act” (Pet. 11).

(a) In *Silver*, which involved a particular instance of enforcement of Exchange rules over which the Securities and Exchange Commission had no regulatory jurisdiction (373 U.S. 357), this Court held:

The Securities Exchange Act contains no express exemption from the antitrust laws or, *for that matter, from any other statute*. This means that any repealer of the antitrust laws must be discerned as a matter of implication; and “[i]t is a cardinal principle of construction that repeals by implication are not favored”. Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes [Emphasis added; citations omitted].

Silver also indicated that the burden is on the Exchange to show that its rule is necessary to accomplish that objective. 373 U.S. at 364-365.*

We submit that "the principle that exchange self-regulation is to be regarded as justified in response to antitrust charges only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act" (*Silver*, 373 U.S. at 361)—at least with respect to Exchange practices beyond the supervision of the Securities and Exchange Commission⁷—is equally applicable in reconciling, under the Supremacy Clause or the doctrine of preemption, the Securities Exchange Act with state law governing the activities of an exchange or its members. That inquiry, in turn, requires a full development of all the pertinent facts relating to the self-regulatory functioning of the exchange with respect to the subject

* The Antitrust Division of the Department of Justice and the Securities and Exchange Commission are in disagreement over the basis upon which the Securities Exchange Act and the antitrust laws are to be reconciled with respect to Exchange practices subject to the regulatory jurisdiction of the Commission. The Commission's position is that the propriety of such stock exchange rules and practices is to be tested by the Commission under the standards of the Securities Exchange Act without regard to the standards of the antitrust laws. The Antitrust Division, on the other hand, believes that the existence of Commission authority to review exchange rules confers no antitrust immunity; that such immunity exists only upon demonstration that the immunity is necessary to make the Securities Exchange Act work; and that that determination is to be made by a court. Cf. *Thill Securities Corporation v. New York Stock Exchange*, 433 F. 2d 264 (C.A. 7), certiorari denied, 401 U.S. 994. As explained in this memorandum, this case is not an appropriate vehicle to resolve that issue.

⁷ See note 6, *supra*.

matter to which state law is sought to be applied, and a detailed and discriminating application of the pertinent legal and policy considerations to the facts thus developed. No record on these issues was developed in the California courts, however, and those courts were never requested to and did not make such inquiry or analysis.

While, so far as we are aware, the particular Exchange rule here in issue has never been determined to be either within or beyond the Commission's regulatory authority, even that issue was not raised below. Nor was there any analysis of the extent to which, if at all, supersession of state law by the Exchange rule was "necessary to make the Securities Exchange Act work" (*Silver, supra*, 373 U.S. at 357). Although Merrill Lynch contended in the trial court that the securities industry was "highly regulated," it did so in the context of arguing that a valid contract to arbitrate existed between itself and Ware.⁸ *Silver* was not cited. In the California Court of Appeal, Merrill Lynch reviewed extensively the regulatory framework of the securities industry, but again the thrust of its argument was to establish that there was, in contractual terms (*i.e.*, mutuality of obligation, consideration), a valid agreement to arbitrate which was enforceable by Merrill Lynch.⁹

⁸ See Merrill Lynch Petition to Compel Arbitration, 1 R., 134-135; Merrill Lynch Reply Memorandum, 1 R., 191-192. ("R." references are to the two-volume record in this case, on file with the Clerk of this Court.)

⁹ See Merrill Lynch Brief in the California Court of Appeal, 2 R., Ex. A., 33-39.

With regard to the validity of the forfeiture provision in its profit-sharing plan, Merrill Lynch's primary argument on ap-

Since there is not an adequate record on these issues and the California courts did not decide them, it would be inappropriate for this Court to consider them.

(b) Aside from the *Silver* issue, Merrill Lynch's argument ignores the general rule that state and federal antitrust claims are not arbitrable, even where the claim is asserted as a defense to an otherwise valid contractual duty to arbitrate. In *Associated Milk Dealers, Inc. v. Milk Drivers Union*, 422 F. 2d 546, 552 (C.A. 7), the court held that "to await the arbitrator's award before allowing the defense of illegality to be raised would be contrary to sound policy. Illegality under the antitrust laws concerns broad public interests transcending the private objectives of the parties."¹⁰ Accord, *Power Replacements, Inc. v. Air Pre-*

peal was that the provision was valid under California law. It did state, following this argument, that "[e]ven assuming that no significant factual distinction exists between a pension plan as in *Muggill* [v. *Rueben H. Donnelly Corp.*, 62 Cal. 2d 239, 398 P. 2d 147] and a Profit Sharing Plan, as here, there is serious doubt as to whether state law is paramount to the federal regulatory policies embodied in the securities laws." Merrill Lynch Brief in the California Court of Appeal, 2 R., Ex. A, 50. However, Merrill Lynch's brief moves from this statement directly to an argument that a state antitrust law may not make illegal that which is legal under the federal antitrust statutes. *Id.* at 51-54. Again, *Silver* was not cited at this point, nor was the court requested to make the type of analysis required by *Silver*.

¹⁰ In *Associated Milk Dealers, Inc.*, *supra*, responding to an argument by the party invoking the arbitration clause that the arbitrator could consider whether the challenged contract provision violated the antitrust laws, the court stated (422 F. 2d at 552):

"We disagree. Arbitrators are ill-equipped to interpret the antitrust laws and their consideration of possible violations

heater Co., 426 F. 2d 980 (C.A. 9); *A. & E. Plastik Pak Co. v. Monsanto Co.*, 396 F. 2d 710 (C.A. 9); *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F. 2d 821 (C.A. 2); *Aimcee Wholesale Corporation v. Tomar Products, Inc.*, 21 N.Y. 2d 621, 237 N.E. 2d 223 (holding state antitrust claims not arbitrable). See also Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U. L. Rev. 1072 (1969); Aksen, *Arbitration and Antitrust—Are They Compatible?*, 44 N.Y.U. L. Rev. 1097 (1969).¹¹

Coenen v. R. W. Pressprich & Co., 453 F. 2d 1209 (C.A. 2), is not to the contrary. Indeed, the court expressly acknowledged that the general rule was that antitrust claims were not arbitrable; however, it affirmed a stay of an action by an allied member of the Exchange against a member firm under the Exchange compulsory arbitration rules solely on the ground that plaintiff's agreement to arbitrate was made after the dispute arose. Such cases are recognized as exceptions

would add little. Indeed an agreement requiring arbitration of private antitrust claims would probably be unenforceable, *Silvercup Bakers, Inc. v. Fink Baking Corp.*, 273 F. Supp. 159, 162 (S.D. N.Y. 1967). Thus we hold that if the union can establish that Article 20 * * * is illegal [under the antitrust laws], arbitration of the dispute between the parties is not required."

¹¹ The author of the latter article, the General Counsel of the American Arbitration Association, urged re-examination of the law holding antitrust and arbitration incompatible. However, he described the present state of the law as follows (44 N.Y.U. L. Rev. at 1097):

"There is almost unanimous concurrence by ample judicial authorities that arbitrators are not permitted to resolve violations of antitrust laws, and it makes no difference whether the dispute involves a collective agreement, or whether state or federal antitrust policy is under consideration."

to the rule that antitrust claims are not arbitrable, since a post-dispute promise to arbitrate may be regarded as equivalent to an agreement to settle an existing private action. 453 F. 2d at 1215.¹²

(c) The holding of *Dickstein v. duPont*, 443 F. 2d 783 (C.A. 1), is not inconsistent with the result here. There, a registered representative employed by an Exchange member firm sued for breach of contract because his employer had paid him an allegedly inadequate finder's fee, and urged that his arbitration agreement was illegal under the Sherman Act. The district court stayed the action pending arbitration, noting at the outset that under *American Safety Equip., supra*, resolution of plaintiff's Sherman Act claim was a matter for the court and not the arbitrators. The court then stated that it was not readily apparent that conditioning approval of employment on submission of disputes to arbitration was anticompetitive and alternately that assuming there was a restraint of trade, the arbitration provision "does not derogate from the self-regulatory grant of the Securities [Exchange] Act." 320 F. Supp. 150 at 153-154 (D. Mass.).

The court of appeals affirmed, stating that plaintiff, by asserting that the agreement to arbitrate violated the antitrust laws, stood in the same position as one who seeks to defend a contract suit by asserting that the contract itself is illegal under the antitrust laws, and that under *Kelly v. Kosuga*, 358 U.S. 516, such defenses may not be raised unless "the intrinsic illegal-

¹² In addition, the court characterized plaintiff's complaint as containing "no more than perfunctory and formal allegations of an antitrust claim * * *." 453 F. 2d at 1215.

ity of the contract is so clear that enforcement would make a court party to the precise conduct forbidden by the law." 443 F. 2d at 786. The court of appeals then examined plaintiff's antitrust claim in detail, concluding that it had no merit. *Id.* at 786-788."

Applying this general approach to the present case, Ware's underlying claim is, as the California courts held, well-founded on the state statute condemning forfeiture provisions as restraints of trade. His challenge to application of the compulsory arbitration provision does not rest on a speculative claim that such provisions in and of themselves violate the federal antitrust laws. Rather, it too is well grounded in state law, and the California court implicitly concluded that enforcing the arbitration provision would, in the language of *Kelly, supra*, 358 U.S. at 520, "make the courts a party to the carrying out of the very restraints forbidden by the" Labor Code.

3. Finally, Merrill Lynch contends that imposition upon it of diverse state standards relating to restraints on its employees amounts to an undue burden upon its ability to operate in interstate commerce. But in

¹⁸ It was thus unnecessary for the court of appeals in *Dickstein* to reach its alternative ground of decision that the exchange's arbitration rule was within "the self-regulatory grant of the Securities Exchange Act which is a partial exception to the antitrust laws." 443 F. 2d at 787-788. The Antitrust Division further believes that although the court in *Dickstein* suggested that the plaintiff had "to prove the rule was outside the self-regulatory grant of the Securities Act" (443 F. 2d at 787), both *Silver* and *Thill, supra*, indicate that the burden of justification is on the Exchange. The court in *Dickstein* also made no mention of the substantial body of law, discussed above, that antitrust claims are not arbitrable.

this respect, its situation is no different from that of any other corporation operating nationally which is subject to the varying provisions of state law governing relationships with individual employees,²⁴ at least insofar as not superseded by federal law. That the state law involved may in part reflect state competitive policy makes no difference.

It is well-recognized that state laws preserving competition can effectively complement federal antitrust policy, and even, in the exercise of the state's reserved police powers, go beyond it, so long as the functioning of the federal system is not disturbed. Cf. *Standard Oil Co. v. Tennessee*, 217 U.S. 413, 421-422; *Puerto Rico v. Shell Co.*, 302 U.S. 253, 261-263. See, e.g., Flynn, *Federalism and State Antitrust Regulation*, 80-96, 150-180 (1964); Note, *The Commerce Clause and State Antitrust Regulation*, 61 Col. L. Rev. 1469 (1961). This Court's dictum in *Flood v. Kuhn*, 407 U.S. 258, 284, concerning application of state antitrust laws to the special situation of professional baseball is not to the contrary, since application of the California law, as this record now stands, does not conflict with federal policy.

²⁴ Merrill Lynch acknowledges (Pet. 12) that other states have, apparently without challenge in this Court, similarly condemned forfeiture provisions of the kind involved herein.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1973.



Supreme Court, U. S.
FILED

MAR 22 1973

MICHAEL RODAK, JR., CLERK

**In the Supreme Court of the
United States**

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

DAVID WARE, et al.,
Respondents.

**On Writ of Certiorari to the Court of Appeal of the State
of California for the First Appellate District**

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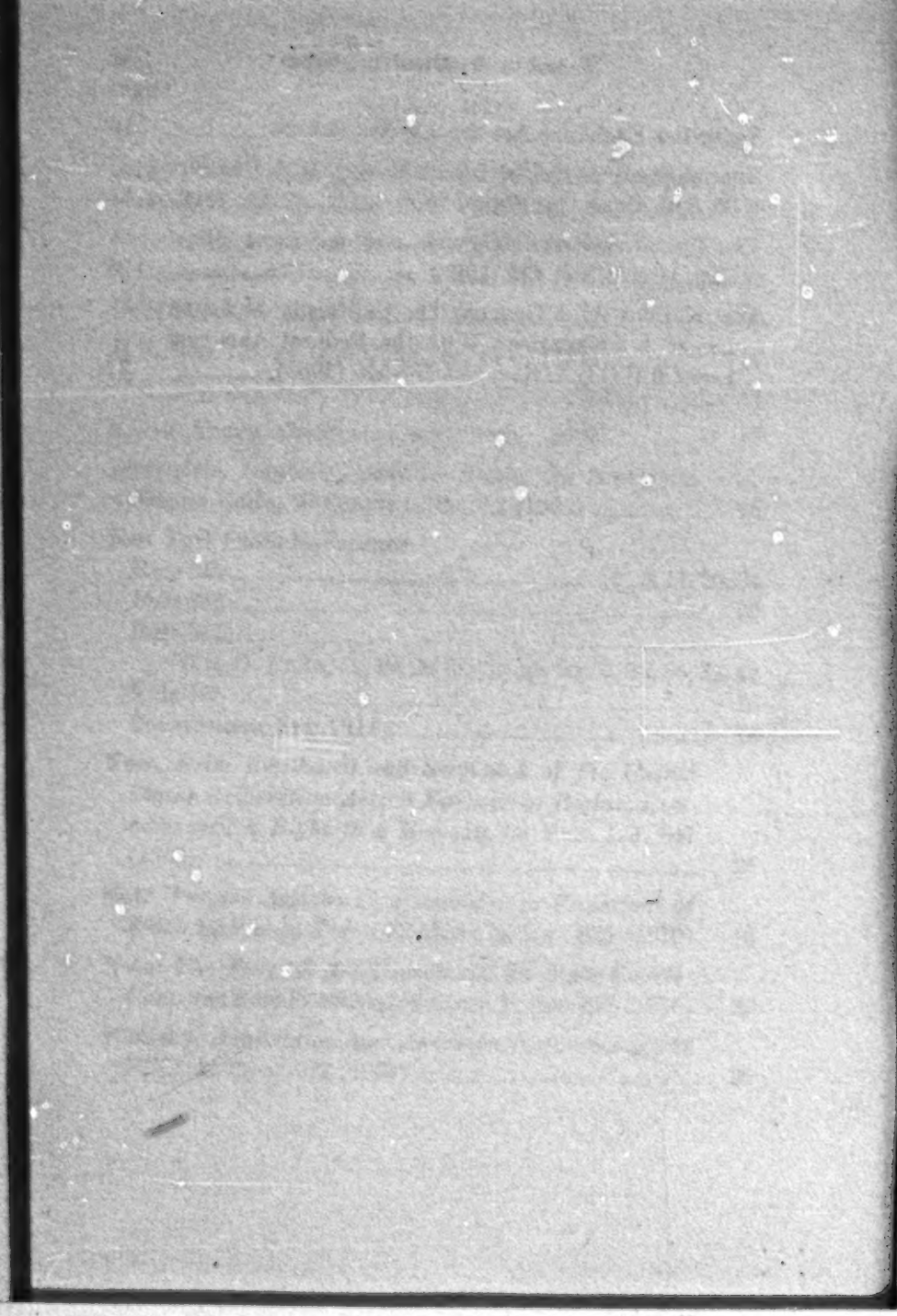
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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,

Petitioner,

v.

DAVID WARE, *et al.*,

Respondents.

On Writ of Certiorari to the Court of Appeal of the State
of California for the First Appellate District

Brief for the Petitioner

OPINION BELOW

The opinion of the Court of Appeal (App. 57-68) is reported at 24 Cal.App.3d 35, 100 Cal.Rptr. 791 (1972). No opinion was rendered by the Superior Court of the State of California, for the City and County of San Francisco.

JURISDICTION

The decree of the Court of Appeal for the First Appellate District affirming the order denying arbitration was

entered on March 15, 1972. (App. 57).¹ A timely petition for hearing in the California Supreme Court was denied on May 10, 1972.

On August 3, 1972 by order of Mr. Justice Douglas the time within which to file a petition for certiorari was extended to August 23, 1972. The petition was filed on August 23, 1972, and was granted on January 22, 1973. This Court's jurisdiction rests upon 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

1. Does a state law permitting actions for wages to be maintained notwithstanding private arbitration agreements interfere and conflict with federal law and policy when

1. Both Respondent and the United States as *amicus curiae*, in their opposition to the petition for writ of certiorari, suggested the court of appeal's decision was not a final judgment for purposes of review by way of certiorari under 28 U.S.C. § 1257. They rely on *Baltimore Contractors, Inc. v. Bodinger*, 348 U.S. 176 (1955). There, however, the district court found no agreement to arbitrate. Here the court of appeals did find an agreement. Moreover, recent decisions of this Court suggest limitations on the *Baltimore Contractors* rationale.

In *Mercantile Nat'l Bank v. Langdeau*, 371 U.S. 555 (1963), this Court invoked its jurisdiction over a Texas Supreme Court order improperly interpreting a federal statute dealing with venue of actions against national banks. The Court believed "that it serves the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine now in which state courts appellants may be tried rather than to subject them, and appellee, to long and complex litigation which may all be for naught if consideration of the preliminary question of venue is postponed until the conclusion of the proceedings." 371 U.S. at 558. The same logic applies here. It makes little sense, particularly in considering the expeditious and economic effect of arbitration, to remit this action to a trial and subsequent review if arbitration is the proper forum to resolve the dispute. Arbitration is an issue wholly separate from and independent of the merits such as to satisfy finality requirements. See, e.g., *Local No. 438, Construction & General Laborer's Union v. Curry*, 371 U.S. 542 (1963). The practical importance of a prompt decision on the federal question is sensible and must be reconciled with a literal interpretation of finality under section 1257. In addition, an important national policy would be frustrated by denial of review at this juncture.

applied to deny arbitration between an employer and former employee who have entered into a written arbitration agreement required by a New York Stock Exchange rule which was promulgated as part of the federal self-regulatory scheme authorized by Congress in section 6 of the Securities Exchange Act of 1934?

2. Does the application of a state antitrust law, declaring void any contract by which a person is restrained from engaging in a lawful occupation to a provision in a profit-sharing plan of a national securities dealer providing for forfeiture of vested interests if an employee voluntarily terminates his employment and is employed by a competitor, constitute an impermissible burden on interstate commerce where the employer is engaged in interstate commerce in a federally regulated industry, where the plan operates in interstate commerce, where the plan requires equitable and uniform application, and where the provision is valid under the laws of other states and the laws of the United States?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

§ 78f. *Registration of national securities exchanges.*

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents below specified:

• • •

(2) Such data as to its organization, rules or procedure, and membership . . .

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange;"

• • •

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder, and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

§ 78bb. *Effect on existing law.*

• • •

(b) Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, . . .

§ 78cc. *Validity of contracts.*

• • •

(2) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

California Business & Professions Code

§ 16600. *Invalidity of Contracts.*

Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

California Labor Code

§ 229. *Actions to enforce payment of wages; effect of arbitration agreements.*

Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement.

STATEMENT OF THE CASE

Respondent, a former employee of Merrill Lynch, filed an action on behalf of himself and other former California employees who had voluntarily terminated employment with petitioner and entered into employment with Merrill Lynch's competitors. He sought declaratory relief and damages, alleging that a provision of Merrill Lynch's profit-sharing plan was invalid under California Business & Professions Code section 16600. (App. 2-7). The plan provides that an employee who voluntarily terminates his employment and enters into employment with a competing stockbroker loses his interest in the plan. (App. 38).

Section 16600 of the Business & Professions Code makes void any contract by which an individual is restrained from engaging in a lawful occupation.

Merrill Lynch answered and raised various defenses, including the defense that application of California law deprived it of the benefits of due process and equal protection under the laws and Constitution of the United States, that its plan operated on an interstate basis, and that the forfeiture provision was valid under federal and New York law, the latter being a choice-of-law provision in the plan. (App. 45-50). It also petitioned for an order compelling

arbitration on the basis of a written agreement between it and respondent and all other members of the class. (App. 51-55). The arbitration agreement is contained in a Form RE 1 of the New York Stock Exchange. Rule 345 of the Exchange, of which Merrill Lynch is a member (App. 55-56), was promulgated pursuant to section 6 of the Securities Exchange Act of 1934 and requires registration of all persons employed as registered representatives, as were respondent and his class. (Appendix A to Brief). Rule 347(b) and the Constitution of the Exchange, also promulgated under the same statute, require arbitration of employment disputes between member firms and their employees. *Ibid.*

These points were raised in the trial court in a memorandum supporting the petition to compel arbitration and in a reply memorandum to respondent's opposition. (1 R. 135-37). Respondent opposed arbitration on the grounds that no contract existed, that if it did, it was adhesive and that, in any event, since section 16600 made the forfeiture provision illegal, he could not be required to arbitrate a contract in restraint of trade under California law. He also moved to determine the action be maintained as a class action. The trial court, by minute order, granted the class action motion and denied the petition to compel arbitration. (App. 37). It did not state any ground for the latter action even though requested to make findings of fact and conclusions of law. (1 R. 201). Merrill Lynch appealed that order.

On appeal, and without benefit of findings of fact or conclusions of law, Merrill Lynch challenged the order on all possible grounds, both state and federal. (2 R., Exhibit A). With respect to federal grounds, it contended that the self-regulatory scheme imposed by federal law in the Securities Exchange Act of 1934, including the delegation of authority to the Exchange and the Exchange's

promulgation of the arbitration rule, was paramount to state law (2 R., Exhibit A, pp. 33-35, 50), that state law could not be applied where interstate commerce was affected (2 R., Exhibit G, pp. 51-55), and that federal comity required state law to yield to federal supremacy in the antitrust and securities areas in order to achieve equitable and uniform application of federal arbitration policies (2 R., Exhibit A, p. 55).

On appeal the former employee, for the first time, asserted the bar of Labor Code section 229. (2 R., Exhibit B, pp. 30-31). After argument the court requested additional briefing (2 R., Exhibit D), including the application of Labor Code section 229. On the latter point, Merrill Lynch referred the court to its brief filed in the companion case (2 R., Exhibit E).²

The court of appeal, although agreeing a valid arbitration contract existed, rejected Merrill Lynch's contentions and relied primarily on California Labor Code section 229 which provides that actions for wages—the court equated profit-sharing benefits with wages—can be maintained without regard to arbitration agreements. (App. 57-68). It affirmed the order of the trial court and remitted the action for trial.

These federal contentions were again raised in a timely petition for hearing in the California Supreme Court. (2 R., Exhibit G). The California Supreme Court refused to hear these contentions. (2 R., Exhibit I).³

2. Some five months earlier the same division of the Court of Appeal had reversed an identical order denying arbitration in an action brought by another employee against petitioner. *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal.App.3d 668, 97 Cal.Rptr. 811 (1st Dist. 1971), (App. 69-74). The facts are identical and that employee, ostensibly a member of the class here, was ordered to arbitrate. Labor Code § 229 was also raised on appeal there but not applied in the court's opinion.

3. It also refused to resolve the direct conflict in opinions of the same court of appeal. See Note 2, *supra*.

SUMMARY OF ARGUMENT

1. Section 6 of the Securities Exchange Act of 1934 contains an express Congressional grant of rule-making authority to national stock exchanges. The exchanges have an obligation to enforce their rules. *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963). Pursuant to this federal mandate the New York Stock Exchange promulgated Rule 347(b) requiring arbitration of employment disputes between member firms and their employees. The rule is an integral part of the registration of employees who deal directly with the public and is designed to meet Congressional and industry concern over employment practices and relationships. The purpose of Rule 347(b) is to regulate those relationships, keep disputes out of court, and provide an expeditious and economical forum to resolve employment disputes through the medium of arbitrators familiar with industry custom and practice. A state law which precludes arbitration of employer-employee disputes in an action to recover profit sharing benefits conflicts and interferes with Rule 347(b) and the self-regulatory scheme. It frustrates Congressional purpose. Such an incompatible state law must give way in the face of the rule-making authority so as to prevent disparate results which may arise from application of state law, e.g., *Perez v. Campbell*, 402 U.S. 637 (1971), or from different treatment in state and federal forums, e.g., *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). This is particularly true since federal courts have uniformly upheld the Rule 347.

It is true that a state may have an interest in preserving a judicial forum for its wage claimants just as Congress has an interest in preserving a judicial forum for investors. But Congress has in section 28 expressly approved arbitration as the forum for resolving disputes within the industry. That express approval is also evidence that Congress did

not intend a contrary result under state law for intra-industry disputes.

Finally Congress in section 6(c) also authorized exchange Rules to be consistent with New York law where the Exchange is organized. New York has no statute comparable to the California law on which respondent relies. Application of California law frustrates Congressional intent in this regard as well.

2. In a related case, *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 69), the court of appeals reversed an order denying arbitration. Section 16600 was there raised as a defense to arbitration. Implicit in that ruling is a finding that state law precluding arbitration of contracts restraining trade could not be applied to arbitration under Rule 347(b) because of its conflict with the federal regulatory scheme. The sole distinguishing feature in the court below was Labor Code section 229. The court erred in its application of Labor Code section 229 and, consistent with its prior opinion in *Frame*, arbitration should be ordered. To the extent section 16600 of the Business & Professions Code and state law barring arbitrations of illegal contracts can be construed as an alternative ground of decision, it too must fall under preemption principles for reasons applicable to section 229 and for additional reasons as well: (1) where federally mandated arbitration conflicts with state created rights, different considerations apply than when the concern is with competing policies at the federal level only are concerned; (2) recent federal decisions have upheld arbitration of employment disputes even in the face of federally created rights both under the federal antitrust laws and federal securities laws; and (3) the prior and contrary holding in *Frame* indicates the state's policy considerations are not strong.

Neither *Wilko v. Swan*, 346 U.S. 427 (1953) or *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963) warrant a contrary result. *Wilko*, to the extent it involves special statutory rights which may be considered parallel to section 16600, dealt with *express* Congressional intent to preclude waiver of these rights. Under section 28 a contrary intent appears when dealing with intra-industry disputes. In addition Respondent is not a member of the class designated for protection. The concern in *Silver* as to the total lack of a forum is not present either. Nor are the special circumstances generally considered to make arbitration inappropriate for resolution of antitrust claims. Factors generally thought to preclude arbitration can be accommodated under the California arbitration statute and Exchange rules.

3. The Merrill Lynch Profit Sharing Plan operates on a national level, open to all eligible employees wherever located. Its registered representatives' activities are interstate in nature and contemplate interstate activities. Provisions similar to Article 11.1 are valid and enforceable in other jurisdictions and do not present cognizable federal antitrust claims. *E.g.*, *Austin v. House of Vision, Inc.*, 404 F.2d 401 (7th Cir. 1968). The net effect of the decision below requires compliance with the most stringent standard in order to achieve desired and equitable uniformity in the operation of the Plan. State antitrust law does not apply to either the Plan or the employment relationship because of its interstate nature. *E.g.*, *Kosuga v. Kelly*, 257 F.2d 48 (7th Cir. 1958), *aff'd on other grounds*, 358 U.S. 516 (1959). Section 16600, ostensibly local in operation, is not local in effect and impedes the uniformity required by the interstate nature of the activities involved. As such, it unduly burdens commerce. *E.g.*, *Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959); *Flood v. Kuhn*, 407 U.S. 258 (1972).

ARGUMENT

I.

California Labor Code Section 229 as Applied to an Arbitration Agreement Between a New York Stock Exchange Member Firm and Its Former Employee Conflicts and Interferes with Rule 347(b) of the Exchange Promulgated Under the Authority of Section 6 of the Securities Exchange Act of 1934.

A. INTRODUCTION.

Section 229 of the California Labor Code prohibits arbitration of wage disputes between employer and employee if the employee elects to sue for such wages, unless arbitration is required by a collective bargaining agreement. In contrast, Rule 347(b) of the New York Stock Exchange, promulgated under section 6 of the Securities Exchange Act of 1934, requires arbitration of employment disputes between member firms and their employees.

This case presents in part the question of the constitutionality of the California statute as applied to prohibit arbitration between a member firm and its former employees' claims to recover the monetary value of their rights in the employer's profit sharing plan which were forfeited when the employee voluntarily terminated his employment and went to work for a competitor.

Respondent Ware was employed by petitioner Merrill Lynch in 1958 at its San Francisco, California office in the capacity of a registered representative.⁴ Merrill Lynch is a member of the New York Stock Exchange which is registered under section 6 of the Securities Exchange Act of 1934. Act of June 6, 1934, c. 404, § 6, 48 Stat. 885, 15 U.S.C. § 78f.

Rule 345 of the Exchange (App. A to Brief) requires the registration with, and approval by, the Exchange of any

4. Merrill Lynch designates its registered representatives as "account executives." For purposes of consistency, the term "registered representative" as used in the Exchange Rules will be utilized.

person employed as a registered representative. On September 26, 1958, respondent Ware executed a written application for approval of employment as a registered representative on Form RE-1 of the Exchange and was subsequently approved and registered. (App. 55-56). In becoming registered representative Ware agreed to submit to the jurisdiction of the Exchange. (App. 56). On April 17, 1958 the Exchange had adopted Rule 347(b), which required that any controversy between a registered representative and any member firm arising out of his employment or its termination shall be settled by arbitration in accordance with the Exchange arbitration procedure. (App. A to Brief). Paragraph 30(j) of the RE-1 Form executed by Ware set forth the arbitration language of Rule 347(b). (App. 56).

In March 1969 Ware voluntarily terminated his employment with Merrill Lynch and became employed with a competing broker-dealer and member of the Exchange. As a Merrill Lynch employee, Ware was eligible to participate in its Profit-Sharing Plan For Employees. (App. 8-44). All contributions to the plan were made by Merrill Lynch, and were credited to Ware's account in the Profit Sharing Trust Fund.

Article 11.1 of the plan provides:

"A participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation. . . and engages in an occupation which is in the determination of the Committee, competitive with the Corporation . . . shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960." (App. 38).

On April 18, 1969 the Administrative Committee determined that Ware had voluntarily terminated his employ-

ment with Merrill Lynch and entered into competitive employment. The Committee thereupon caused to be forfeited the rights Ware had in the plan. (App. 52).

Subsequently, Ware, on behalf of himself and all other former Merrill Lynch employees in California brought a state class action for declaratory judgment that Article 11.1 of the Merrill Lynch Profit Sharing Plan was illegal under Section 16600 of the California Business Code, and for damages in the amount of their forfeited interests in the plan. Merrill Lynch alleged, and there is no dispute, that all members of the class had executed similar or identical RE-1 Forms containing the arbitration agreement, had voluntarily left Merrill Lynch and become employed with competitors, and, as a result, had forfeited their interests in the plan.

The trial court's ruling denying arbitration was made by minute order (App. 57), and without the benefit of findings of fact and conclusions of law, although Merrill Lynch had requested them. (1 R. 201). The court of appeal, citing its prior decision in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal.App.3d 668, 97 Cal.Rptr. 811 (1st Dist. 1971) (App. 69-74), determined that a written agreement to arbitrate did exist (App. 61-64), but held that California Labor Code section 229 precluded arbitration.

E. WHEN CONSIDERED UNDER THIS COURT'S RECENT PREEMPTION DECISIONS, SECTION 229 IS AN OBSTACLE TO THE FULFILLMENT OF THE CONGRESSIONAL OBJECTIVES UNDER A FEDERAL REGULATORY SCHEME.

In considering cases involving preemption questions this Court has developed and followed a framework designed to fulfill the Court's function "to determine whether a challenged state statute 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives

of Congress.' " *Perez v. Campbell*, 402 U.S. 637, 649 (1971), quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

The decision making process under the *Hines* test is a two-step process as outlined in *Perez*. First, the construction of the statutes in question is ascertained and, second, a determination is made as to whether they are in conflict in the Constitutional sense. *Perez v. Campbell*, 402 U.S. at 644.

Section 229 of the California Labor Code was adopted in 1959. Cal.Stats. 1959, Ch. 1939, § 1, p. 4532. Prior to the present case no California court had construed section 229. Finding the intent to be "quite clear," the court of appeals indicated that "while the strong public policy of the State favors arbitration . . . the intent of the statute is to provide in the first instance a judicial forum where there exists a dispute as to wages." (App. 66) (citation omitted). Having determined this "clear intent," the court then equated profit sharing benefits with "wages" as used in the the statute and concluded that the statute barred arbitration notwithstanding the arbitration agreement. This Court is bound by the court of appeals ruling as to the construction of the statute, e.g., *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335, 337 (1944), even though it is not the authoritative construction apparent in *Perez*.

On the other hand, the authoritative construction of Rule 347(b) is apparent from recent federal cases, and from the nature of the self-regulatory scheme, as well as the Congressional purposes behind the 1934 Act.

In recent federal decisions, actions were brought by registered representatives to recover finder's fees, *Dickstein v. DuPont*, 320 F.Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971), commissions, *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972), and for alleged violations of Rule 10(b)-5 of the Act in the sale back to

Merrill Lynch of stock acquired in a stock option plan, *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH FED. SEC. L. REP. ¶ 93742 (E.D. Pa. Jan. 19, 1973). In each of the above cases the employee had executed an RE-1 Form and agreed to arbitrate under Rule 347(b). In each case the employer sought arbitration under the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 671, 9 U.S.C. § 3, or state law.⁵ Arbitration was opposed in *Dickstein* on the ground that the RE-1 Form violated the Sherman Act, Act of July 14, 1890, c. 708, 26 Stat. 289, 15 U.S.C. § 1; in *Rust* on the ground of duress; and in *Ayres* on the ground that section 29 of the Act precluded arbitration, e.g., *Wilko v. Swan*, 346 U.S. 427 (1953).

In each instance, relying in part on *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), these courts ordered arbitration. Their collective rationale can be summarized as follows: (1) Under section 6 Congress gave broad rule-making powers to the exchanges, and all rules had to be approved by the Securities Exchange Commission as fulfilling the object of fair dealing and investor protection; (2) Rule 347(b) comes within the rule-making grant because of the Exchange's legitimate interest in deciding how disputes between its members and their employees are to be resolved, and in fostering harmonious relationships among the varied groups whose daily activities play a role in the complex operations of the Exchange and the industry; (3) Congress evidenced specific approval of the Exchange's arbitration rules by exempting them under section 28(b) from the nonwaiver provisions of section 29(a); and (4) the nature of the employment relationship and the practices

5. E.g., *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715, 716 (S.D.N.Y. 1972) (N.Y.C.P.L.R. § 7501). The United States Arbitration Act and the New York and California Acts are virtually identical in terms.

peculiar to the Exchange suggest the reasonableness of prompt and economic arbitration by those experienced in trade practices and customs.

Arbitration pursuant to related New York Stock Exchange rules (e.g., Rule 481) and the Exchange constitution (N.Y.S.E. Constitution Art. VIII) has also been consistently enforced by federal courts in disputes between members or members and nonmembers.⁶ The analysis made by these federal courts support the arbitration rules in both a positive and negative sense. As to the latter each noted that since the principal purpose of the 1934 Act was for the protection of investors, Congressional policy was not thwarted by enforcing arbitration between members, members and nonmembers, employees of members, or similar combinations pursuant to exchange rules. On the positive side these courts observed that the supervised system of self-regulation not only *requires* the adoption of rules by exchanges but imposes an obligation of rule enforcement on them as well. See SEC, Report of Special Study of Securities Market, H. R. Doc. No. 95, 88th Cong., 1st Sess., Pt. I, p. 3; *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).⁷ Failure to enforce the arbitration rules frus-

6. See e.g., *Brown v. Gilligan, Will & Co.*, 287 F.Supp. 766 (S.D.N.Y. 1968); *Isaacson v. Hayden, Stone, Inc.*, 319 F.Supp. 929 (S.D.N.Y. 1970); *Coenen v. B. W. Pressprich & Co.*, 329 F.Supp. 1296 (S.D.N.Y. 1971), *aff'd*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971); *Revenue Properties Litigation Cases v. Cohn, Delaire & Kaufman*, 451 F.2d 810 (1st Cir. 1971).

7. That an Exchange Rule has the force of law seems fairly well accepted. *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178 (2d Cir.), *cert. denied*, 358 U.S. 817 (1966); *Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969); *cf.*, *Silver v. New York Stock Exchange*, 353 U.S. at 365. See generally Lowenfels, *Implied Liabilities Based On Stock Exchange Rules*, 66 COLUM. L. REV. 12 (1966); Note, *Private Actions As a Remedy For Violations of Stock Exchange Rules*, 83 HARV. L. REV. 825 (1970).

trates that policy, e.g., *Coenen v. R. W. Prossprich & Co.*, 453 F.2d 1209, 1212 (2d Cir. 1972) cert. denied, 406 U.S. 949 (1972).⁸

This Court's decision in *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), sheds substantial light on Congressional intent and the statutory scheme. Recognizing that Congress clearly intended to create a "federally mandated duty of self-policing by exchanges," the Court referred to section 6 as the source of authority for the delegation, 373 U.S. at 352. Mr. Justice Goldberg concluded that part of the statutory duty is an obligation "to formulate rules governing the conduct of exchange members and that section 6(d)'s requirement that an exchange's rules be 'just and adequate to insure fair dealing and to protect investors' has obvious relevance to the area of rules regulating the conduct of an exchange's members." 373 U.S. at 353. In evaluating the Congressional purpose the Court noted that arbitration, particularly involving nonmembers was not only "important" but deliberately designed to fulfill the section 6(b) and 6(d) duties. 373 U.S. at 353-54 & n. 9.

The fact that respondent here is not a "member" of the exchange is not relevant, as the court of appeals noted. (App. 61-64). It is an unavoidable result of including rules governing member-nonmember relationships under the Exchange's power to self-regulate, 373 U.S. at 356.

Congressional intent can also be gleaned from the overall regulatory scheme imposed under the Securities Exchange Act of 1934 and the language of section 6 itself. Prior to 1934 the securities industry was in large part unregulated by government. Congressional enactment in 1934 of the Act, and subsequent enactment of other statutes

8. The Commission itself takes the position that the Exchange rules govern all member dealings, even those not related to Exchange transactions. E.g., 5 LOAN, SECURITIES REGULATION 3188-89 (Supp. 1969).

dealing with the industry, did not however, result in a total displacement of the historical process of self-regulation; rather it continued it through a statutory scheme of self regulation supervised by the Commission.

Section 6 mandates the registration of exchanges and enforcement of rules and by-laws promulgated by them. Copies of the exchange constitution, articles, rules and by-laws must be submitted to the Commission pursuant to section 6(a)(3). If the Commission finds the exchange is organized so as to comply with the Act and its rules and regulations, and that the rules of the exchange "are just and adequate to insure fair dealing and to protect investors," the exchange is then registered. By the terms of the Congressional grant in section 6(d) Commission silence in 1958 when Rule 347(b) was adopted is authoritative approval of the Rule as meeting the statutory standard.

In addition to the plain statutory language and the Congressional intent as articulated in *Silver*, there is other evidence that Congress did, and continues to, intend the exchange's function to include the type of rule embodied in Rule 347(b).

Section 6(e) of the Act permits an exchange to adopt and enforce any rule not inconsistent with the Act, its rules or regulations, or "the applicable laws of the State in which it is located." The implication in this section is that Congress intended to supersede the law of other states. The New York Stock Exchange is a corporation organized under the laws of New York. 2 CCH N.Y.S.E. Guide, p. 2101. New York has an arbitration statute identical to that of California. Compare N.Y.C.P.L.R. § 7501 (McKinney 1963), with California Code of Civil Procedure § 1281. New York does not, however, have a provision in its labor laws comparable to section 229, although it does have laws relating to wages, e.g. N.Y. Labor Law § 198 (McKinney 1972 Supp.). Thus,

Rule 347(b) is entirely consistent with section 6(c) of the Act, and applicable New York law. Cf. *Rust v. Drexel Firestone Inc.*, 352 F.Supp. 715, 718 (S.D.N.Y. 1972).

That employment practices and relationships were and are of concern to both the Securities Exchange Commission and Congress is not only clear from the act, but from continuing observations of both entities. See, e.g., Securities Exchange Act Release No. 34-9908 (Dec. 14, 1972), CCH Fed.Sec.L.Rpt. ¶ 79141 (non-discrimination in employment). In 1964 when Congress enacted amendments to the 1934 Act based upon the Special Study, Act of Aug. 20, 1964, § 7, 78 Stat. 574, 15 U.C.S. § 78o-3, one important area in which it acted involved improved qualifications and controls for broker-dealers and their employees. See, e.g., H.R. Rep. 1418, 88th Cong. 2d Sess. 3-4 (1964).

It is true that the 1934 Act, and other federal securities legislation contain provisions reserving the jurisdiction of state securities commission and "other rights and remedies that may exist at law or in equity." E.g., Act of June 6, 1934, c. 404, § 28, 48 Stat. 903, 15 U.S.C. § 78bb(a). Section 28, however, is not the general type of savings clause ordinarily required to defeat a preemption or supremacy argument. See, e.g., *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). Nor should it be so interpreted in the face of the policies and purposes behind section 6, the need for national uniformity, the lack of a traditional area of state regulation, and the direct conflict between Labor Code section 229 and Rule 347(b).

Having been mandated a self-regulatory schema, the Exchange has fulfilled its duty in part by adopting Rule 347(b) to cover disputes between member firms and their employees. Rule 347(b) contains nothing antithetical to the general policies sought to be furthered in the Act. On the

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contrary it is entirely consistent with and in furtherance of the Exchange's section 6 duties.

The promotion of the policy of insuring fair dealing and protecting investors is also served by the rule. It regulates the relationship between member firms and their employees, the latter being more closely associated directly with the investing public as representatives of member firms. Rule 345(a)(1) of the Exchange requires registration and approval of these representatives, prescribes a training program, examination, investigation and certain other matters. See, *e.g.*, 2 CCH N.Y.S.E. Guide ¶ 2345. Rule 346 prescribes limitations on their duties. These rules, together with Rule 347(b), all relate to the Exchange's duty to protect the investing public, as required by the Act. The most logical manner in which to promote that objective is to exercise the rule-making function over the employment relationship. It is those employees who assist the investing public in securities transactions. Congress attributed many of the market abuses which the 1934 Act was designed to prevent to these employees. The 1964 amendments to the Act evidenced continuing Congressional concern in this area. Failure to give full effect to these rules transgresses legislative policy.

An additional, and fundamental concern, is the lack of uniformity which would result from upholding the application of Labor Code section 229.

Self-regulation would be thwarted by permitting arbitration under the laws of one state, *e.g.*, *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972), but not in another such as California. To paraphrase *Perez*, to uphold section 229 would obviously be to legislate in such a way that the self-regulatory grant in rule 347(b) means one thing in one state and something else in other states—depending on state law—a result implicitly prohibited by

the uniform nature of the self-regulatory grant in the 1934 Act. Conflicting interpretation, as here and as in *Rust*, stimulates judicial disputes and impedes resolution of conflicts by other means. Lack of uniform treatment makes the need for uniformity in the area particularly compelling. Such uniformity can only come by permitting the arbitration provisions of the Exchange rules to prevail over inconsistent local laws. One cannot impute to Congress an intent that Exchange rules promulgated under section 6 might not be uniform in application, particularly since the Exchange's role in the regulatory scheme is "uniquely important." SEC, Report of Special Study of the Securities Market, H.R. Doc. No. 95, 88th Cong., 1st Sess. pt. 4, at 570 (1963); *Silver v. New York Stock Exchange*, 373 U.S. 341, 349 (1963). Within its sphere of authority (i.e., rulemaking) it occupies a position similar to, if not equally important as, the Securities Exchange Commission. As such, its rules should be capable of enforcement on a uniform basis. See, e.g., *Schwabacher v. United States*, 344 U.S. 182 (1948).

If section 6 meant nothing more than that an exchange should draft rules incapable of enforcement, there would have been no purpose for the inclusion of section 6(a)(8) in the Act. Cf. *Bright v. Philadelphia-Baltimore-Washington Stock Exchange*, 327 F.Supp. 495 (E.D. Pa. 1971). One cannot impute to Congress an intent to draft a meaningless statute.

California's adoption of section 229 to provide the employee an election of forums is not a matter of traditional local concern, where the employer is engaged in interstate commerce in a national industry and where Congress has given the Exchange the authority to govern its internal affairs. Under section 301 of the Labor Management Relations Act, Act of June 23, 1947, c. 120, § 301, 61 Stat. 156, 29 U.S.C. § 185(a), this Court has held that the issue of

arbitrability of a dispute must be resolved by the application of federal substantive law fashioned by federal courts. See, e.g., *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957). In such a case "incompatible doctrines of local law must give way to principles of federal labor law," *Local 174 Teamsters, etc. v. Lucas Flour Co.*, 369 U.S. 95, 102 (1962). Although the 1934 Act does not itself command arbitration as does the Labor Management Relations Act, Congress has, in section 6, expressly authorized exchanges to promulgate rules and regulations, and has indicated that such rules may and should govern the employment relationship within the securities industry. Having promulgated Rule 347(b) consistent with that grant of power, it should be entitled to enforcement as a matter of federal substantive law in the same manner as arbitrations are enforced in the federal labor law context or under the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 670, 9 U.S.C. §§ 1 et seq.; see, e.g., *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), cert. dismissed, 364 U.S. 801 (1960); *Dickstein v. Dupont*, 320 F. Supp. 150 (D. Mass. 1970), aff'd, 443 F.2d 783 (1st Cir. 1971).

This Court and lower federal courts have consistently endorsed the suitability of arbitration to resolve federally-created rights, e.g., *Wilko v. Swan*, 346 U.S. 427 (1953) (dictum); *Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), cert. denied, 406 U.S. 949 (1972) (violation of Securities Exchange Act, Sherman, and Clayton Acts).⁹ There is even more reason to do so here.

The court of appeal's construction of section 229 in effect preserved the right of a wage claimant to sue in California

9. A number of other cases are collected in Mr. Justice White's dissenting opinion in *U.S. Bulk Carriers, Inc. v. Arguelles*, 400 U.S. 351, 374-75 (1971).

notwithstanding an arbitration agreement. Respondents are not uncompensated wage claimants but highly compensated employees engaged in a specialized occupation and utilizing confidential information supplied them by the Exchange, the employer, and their customers. Implicit in the court's construction is a theory that section 229 precludes waiver of the right to bring a judicial action for relief. A similar provision is contained in section 29(a) of the 1934 Act, Act of June 6, 1934, c. 404, § 29, 48 Stat. 903, 15 U.S.C. § 78ec(a). A similar section in the 1933 Act has been interpreted by this Court as precluding arbitration of a claim arising under the Act by a customer against a broker-dealer. See, e.g., *Wilko v. Swan*, 346 U.S. 427 (1953). Underlying the Court's determination was the intent of the 1933 Act to protect investors, 346 U.S. at 435. An analogy can be made to Labor Code section 229 insofar as it was designed to give California wage earners a right to a judicial forum in the first instance.

Unlike *Wilko*, however, respondents are not investors who need protection from the industry. To the investing public respondents are in a real sense the industry itself. As employees of members who are required to be registered and approved by the exchanges, they stand in a similar position as members. Permitting arbitration between them does not defeat the legislative policy, particularly where no statutory securities violations are alleged over which the non-waiver provision would apply.

There is an even more fundamental reason for giving effect to the arbitration provision in the face of a federal non-waiver statute. Section 28(b) of the 1934 Act, Act of June 6, 1934, c. 404, § 28(b), 48 Stat. 903, 15 U.S.C. § 78bb (b), exempts from the non-waiver provisions of section 29(a), "any action taken by the . . . exchange to settle disputes between its members" and also "with regard to the

binding effect of such action on any person who has agreed to be bound thereby." The exchange arbitration rules have been consistently interpreted by federal courts as falling within both the Congressional purpose of self-regulation and "action" within the meaning of section 28(b).¹⁰ To permit a state statute which can be characterized as a non-waiver provision to overcome an exchange rule would emasculate section 28(b) and fail to give it effect. It would also result in divergent federal and state decisions depending upon the forum in which the action was brought. If Congress did not intend the federal nonwaiver statute, section 29(a), to overcome the arbitration of disputes under exchange rules exempt from section 29(a) by section 28(b), it surely did not intend a contrary result if the nonwaiver statute were predicated on state law, such as Labor Code section 229.

Laws delegating extensive regulatory powers to administrative agencies are fundamentally different from other types of laws. See, e.g., *San Diego Building Trades Council v. Garmon*, 359 U.S. 236 (1959). In such circumstances, present here, the task of the judicial process is not to make ad hoc determinations based on a particular set of circumstances to ascertain the precise nature of the conflict, but rather to deal with "classes of situations. 359 U.S. at 241. Where Congress has entrusted the administration of the securities industry to centralized agencies, utilizing specialized knowledge, experience and procedure, private activities subject to such regulation should be subject only to the federal scheme; state laws imposing conflicting requirements are presumptively invalid, even if they could also be imposed by federal agencies or quasi-administrative agencies such as the Exchange. Federal statutes delegating broad regulatory authority, as section 6 of the Act, are

10. See cases cited note 6, *supra*.

entitled to the special weight and different considerations exemplified by these federal decisions. See also *Campbell v. Hussey*, 368 U.S. 297 (1961); *Public Util. Comm'n v. United States*, 355 U.S. 534 (1958). The reliance by Congress on the self-regulatory scheme creates the conflict, but Congress alone has that choice. Rule 347(b) of the Exchange fulfills that goal in the area where investor protection is most acute. To permit state law to interfere and conflict with Rule 347(b) frustrates that policy and stands as the "obstacle to the accomplishment and execution of the full purposes and objectives of Congress" under *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

A further reason for application of uniform national treatment to the exclusion of conflicting state law is to prevent the fundamental unfairness that arises from forum shopping.

Had Ware brought his action in federal court based on diversity of citizenship" the petition to compel arbitration and to stay proceedings could have been based upon the United States Arbitration Act, Act of July 30, 1947, c. 392, 61 Stat. 670, 9 U.S.C. §§ 1 *et seq.* (1970). See, e.g., *Dickstein v. DuPont*, 320 F.Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971). Section 2 of the Act provides that agreements to arbitrate future disputes are "valid, irrevocable, and enforceable, save upon such grounds as exist at

11. 28 U.S.C. § 1332 (1970). Ware and his class are California residents. (App. 3). Merrill Lynch is organized outside of California with its principal place of business in New York. (App. 51). Ware's action not only seeks declaratory relief but also seeks to recover each employee's interest in the plan. (App. 6). No amount is alleged and is not required under the California Declaratory Relief Statute, California Code of Civil Procedure § 1060 *et seq.* Discovery has not yet determined the amount in controversy but the possibility exists that removal under 28 U.S.C. § 1441 (1970) arguably exists, e.g., *Fleming v. Colonial Stores, Inc.*, 279 F.Supp. 933 (S.D. Fla. 1968), at least as to some of the class members, e.g., *Snyder v. Harris*, 394 U.S. 322 (1969).

law or in equity for the revocation of any contract." This language is identical with the California arbitration statute upon which the petition was based here. California Code of Civil Procedure § 1231.

Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959), cert. dismissed, 364 U.S. 801 (1960), declared in dictum that Section 2 was both national in scope and equally applicable in state or federal court. *Id.* at 407. It also found that Congress intended by the Act to establish "federal substantive law affecting the validity and interpretation of arbitration agreements." *Id.* at 406¹²

In reaching its conclusion that the Act established federal substantive law, the court in *Robert Lawrence Co.* answered a question left open by this Court's decision in *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956). *Bernhardt* involved a diversity action for damages for discharge under an employment contract containing an arbitration clause. The contract was to be performed in Vermont where a statute permitted revocation of an arbitration agreement at any time before an award. Applying *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), the district court followed Vermont law and denied the stay. The court of appeals reversed. Mr. Justice Douglas' opinion for the majority held that the Act was inapplicable since the contract did not evidence a transaction involving commerce. *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 200-201 (1956).

If the Act is purely procedural, contrary "outcome determinative" state law would be controlling in diversity

12. The Act was originally passed in 1925 to remedy three problems: 1) delays incident to litigation in congested courts; 2) expense of litigation; and 3) the failure through litigation to reach a just result measured by business standards. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); Committee on Trade, Commerce & Commercial Law, *The United States Arbitration Act and Its Application*, 11 A.B.A.J. 153, 155-56 (1925).

cases. *Robert Lawrence Co.* avoided this result by construing section 2 as the source of substantive law. As such the states are bound to apply it under the Supremacy Clause. See e.g., Note, *Erie, Bernhardt and Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy*, 69 *YALE L.J.* 847 (1960); Note, *The Federal Arbitration Act In State Courts: Converse Erie Problems*, 55 *CORNELL L. REV.* 623 (1970).

This reasoning was implicitly adopted by this Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). *Prima Paint* brought a diversity action to rescind a consulting agreement containing an arbitration clause, for alleged fraud in the inducement of the contract. The defendant had requested arbitration of the dispute. Finding the commerce requirement applicable and relying on *Lawrence*, the Court agreed that the issue of fraud in the inducement of the contract was a question for the arbitrators as a rule of federal substantive law, even in the face of contrary state law. 388 U.S. at 399-400.

The Court then fashioned a rule of federal substantive law based upon Congressional purpose and intent. It held that in passing upon a motion to stay pending arbitration "a federal court may consider only issues relating to the making and performance of the agreement to arbitrate." 388 U.S. at 404.

This type of claim was raised in the trial court and before the court of appeal (App. 61-64), just as it was in *Rust v. Drexel Firestone Inc.*, 352 F.Supp. 715 (S.D.N.Y. 1972) (duress), and in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 71-72). The court of appeals held that an arbitration agreement existed under California law. (App. 61). Since the California Act is identical to the federal act, a similar result would be reached in federal court under *Robert Lawrence Co.* and *Prima Paint*. But,

contrary to the court of appeals decision, the inquiry would have stopped there and arbitration been ordered under *Prima Paint*, notwithstanding Labor Code section 229. Given the strong federal policy in favor of arbitration, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. at 404, a state court should concern itself chiefly with fostering uniformity of result in state or federal court by giving effect to the federal right substantially as would a federal court, which is exactly what the court did in *Frame*. Fortuity of suit in a state court rather than a federal court should not lead to divergent results, particularly where section 3 of the Arbitration Act permits reliance on the Act or applicable state law. See, e.g., *United States ex rel. Capolino Sons, Inc. v. Electronic & Missile Facilities, Inc.*, 364 F.2d 705 (2d Cir.), cert. denied, 385 U.S. 924 (1966). To do otherwise gives an unfair advantage to the litigious party.

Except for Labor Code Section 229 the Court of Appeals Would Have Ordered Arbitration Having Implicitly Recognized as It Did in *Frame v. Merrill Lynch* That Application of Business and Professions Code Section 16600 to Prohibit Arbitration Because of the Underlying Illegality of the Noncompetition Clause Conflicts and Interferes with Rule 347(b).

In *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 69-74) the court of appeals reversed the order denying arbitration. Merrill Lynch there had raised the same preemption arguments that are raised here. The *Frame* court, however, "did not consider the effect of section 229 . . . on the arbitration agreement." (App. 66). Section 229, therefore, is the only distinguishing feature in the two cases and except for that section the court below undoubtedly would have reversed the trial court and ordered arbitration. Respondent also agrees that section 229 was the sole basis in distinguishing the cases. (2 R., Exhibit H).

In disposing of the issue of arbitrability both courts examined Article 11.1 in light of section 16600 of the Business & Professions Code. In both cases it was argued that Article 11.1 was illegal under *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 42 Cal.Rptr. 107 (1965),¹³ and that arbitration would not lie to enforce an illegal contract.¹⁴ Nevertheless,

13. *Muggill* involved a noncompetition clause in a pension plan. The employee retired and was then employed by a competitor. The action sought reinstatement in the plan after the forfeiture occurred.

14. E.g., *Loving & Evans v. Blick*, 33 Cal.2d 609, 204 P.2d 23 (1949) (unenforceability of arbitration award on a contract claim by unlicensed contractor); *Alpha Beta Food Markets, Inc. v. Amalgamated Meat Cutters*, 147 Cal.App.2d 343, 305 P.2d 163 (2d Dist. 1956) (denial of arbitration under collective bargaining agreement where agreement allegedly violated state and federal antitrust law).

the *Frame* court ordered arbitration. The only logical interpretation that can be placed on the *Frame* decision is that application of section 16600 to bar arbitration because of illegality conflicted and interfered with Rule 347(b); hence, state law could not be applied with respect to the issue of arbitration. Had it decided otherwise there would have been no reason for the court below to consider Labor Code section 229. Moreover, if the court below was in fact *also* holding that section 16600 barred arbitration, it would presumably have expressly overruled *Frame*. That it did not do so, but relied exclusively on section 229, indicates that it agreed with the necessary implications that follow from *Frame*, including the implication that section 16600 does not, indeed cannot, bar arbitration under Rule 347(b).

Like *Perez*, the expression of state policy is clear. Both *Frame* and *Ware* should be construed in this manner: upholding the arbitration under Rule 347(b) in the face of section 16600. Thus, the only proper issue before the Court here concerns the application of section 229, and it too must fall under preemption doctrines.

It will undoubtedly be argued, however, that section 16600 also precludes arbitration. Assuming this alternative theory is suitable for consideration, section 16600 stands in no different posture than section 229 and should receive similar treatment, particularly where *Frame* makes it clear that section does not represent such a *strong* public policy that might otherwise overcome the preemption hurdle. The same arguments applicable to section 229 can also be directed at section 16600. In addition, other considerations militate against holding section 16600 constitutional insofar as the

opinion below may be construed to apply it as a state law bar to federally mandated arbitration under Rule 347(b).

The relationship of the securities acts and federal antitrust law have been considered both by this court and others. See, e.g., *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).¹⁵ None of these cases have involved the juxtaposition of arbitration and antitrust policies where the arbitration was based on a Congressional grant of authority as section 6 of the 1934 Act, and the antitrust policy was state created.¹⁶ Rather, they involved competing federal statutes and competing Congressional policies. Here the competing policies are at different levels—federal and state.

The relationship also distinguishes cases in which arbitration has been generally held inappropriate. See, e.g., *American Safety Equip. Corp. v. J. P. Maguire Co.*, 391 F.2d 821 (2d Cir. 1968). There the court was concerned with federal antitrust laws and an arbitration agreement contained in a licensing agreement. Here the conflicting policies

15. See also, *Bicci v. Chicago Mercantile Exchange*, ___ U.S. ___, 93 S.Ct. 573 (1973); *Harwell v. Growth Programs, Inc.*, 451 F.2d 240 (5th Cir. 1971), *cert. denied* sub nom. *N.A.S.D. v. Harwell*, ___ U.S. ___, 93 S.Ct. 126 (1972); *Cowan v. New York Stock Exchange*, 256 F.Supp. 462 (S.D.N.Y. 1966), *aff'd*, 371 F.2d 661 (2d Cir. 1967); *Kaplan v. Lehman Bros.*, 250 F.Supp. 562 (N.D. Ill. 1966), *aff'd*, 371 F.2d 409 (7th Cir. 1967), *cert. denied*, 389 U.S. 954 (1968); *Thill Sec. Corp. v. New York Stock Exchange*, 283 F.Supp. 289 (E.D. Wis. 1968), *rev'd*, 433 F.2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971).

16. *Aimco Wholesale Corp. v. Tomar Prods., Inc.*, 21 N.Y.2d 621, 289 N.Y.S.2d 968 (1968), cited below, did involve a conflict between an arbitration clause and a claim under New York's Donnelly Act, but the arbitration clause was injected into the sales contract by agreement of the parties, not because it was required under the authority of a Rule adopted under a power expressly delegated by a legislative authority.

are state laws dealing with restraints¹⁷ and federally mandated self-regulation which has resulted in Rule 347(b). Congress clearly intended exchanges to take the initiative in drafting rules under section 6 of the Act. While competing Congressional purposes may present difficult issues of conflict resolution, no difficulty arises when the conflict is with a state policy. The threat of state antitrust laws such as section 16600 militates against the initiative given the exchanges and, if allowed to prevail, would create an uncertainty as to their legitimacy which would disrupt the scheme.

Nor is there any question that arbitration of disputes runs contrary to any other federal or state policy. Congress in many instances, such as the federal labor laws and the Federal Arbitration Act, has recognized the value of arbitration. California also has a strong public policy favoring arbitration as the court below recognized. (App. 66). Rule 347(b) is consistent with, and enhances those policies. Where the parties have made the arbitration process available for resolution of issues, it is sound and consistent with general approbation of those policies to require it, rather than litigation.

Recent federal cases since *Silver* have also upheld the arbitration rules of the Exchange in the face of federal antitrust complaints, e.g., *Coenen v. R. W. Pressprich & Co.*, 329 F.Supp. 1296 (S.D.N.Y. 1971), *aff'd*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972), or actions alleging violations of the 1934 Act itself, e.g., *Ayres v. Merrill*

17. Respondent has asserted throughout these proceedings that section 16600 is not an antitrust law. While not part of the specific California antitrust law commonly referred to as the Cartwright Act, Business & Professions Code § 16700 *et seq.*, it is part of the statutory scheme to preserve and regulate competition, and may generally be considered a state antitrust law in that sense. See, e.g., Van Kalinowski & Hanson, *The California Antitrust Laws: A Comparison With the Federal Antitrust Laws*, 6 U.C.L.A. Rev. 533, 535-540 (1959).

Lynch, Pierce, Fenner & Smith, Inc., CCH FED.SEC.L.REP. ¶ 93696 (E.D. Pa. Jan. 19, 1973). In *Ayres* the employee's claim was an alleged violation of section 10(b) of the Act in the sale to Merrill Lynch of its stock purchased by him under its stock option plan. The employee was thus in a dual capacity of employee and investor, and the court emphasized the nature of the employment relationship and Rule 347(b). The same rationale applies here. The requirement of arbitration arises out of Rule 347(b). Section 10(b) of the Act, as the court recognized, was of significant and fundamental importance to the operation of the statute. As such, it is as much in the public interest as a state created antitrust right, at least where the right affects individuals involved in a regulated industry and where Congress authorized the Exchange to promulgate rules affecting its members and their employees.¹⁸ Since the Exchange has acted, its rule should not be limited by that alleged state public interest. Moreover, as the *Ayres* opinion notes, and as was recognized in *Frame* (App. 73-74), those questions of public interest are not beyond the province of the arbitrators.

Merrill Lynch recognizes that the *Coenen* decision was predicated in part on the fact that the agreement to arbitrate was made after the dispute arose. A close analysis of the facts in the opinion, however, reveals that neither party was aware of the dispute until after the agreement to arbitrate had been made. Here the controversy (i.e., Article 11.1 of the Plan vis-a-vis section 16600 of the California Business & Professions Code) was present as in *Coenen*, before the arbitration agreement was executed, or simultaneous with its execution. Ware did not become sub-

18. Cf. *Humble Oil & Refining Co. v. Independent Indus. Workers*, 337 F.2d 321 (5th Cir. 1964) (arbitration appropriate under collective bargaining agreement even though complaint alleged unfair labor practice charge).

ject to either Article 11.1 or arbitration until he became an employee. Both obligations were requirements of his employment with Merrill Lynch in the securities industry. As the Special Study authorized by Congress pointed out, deep deficiencies existed in the minimum standards of competency and integrity of industry employees. It suggested that the "gateway to the industry is where government and industry should look first for the solution," since salesmen are the link between the public and member firms. SEC, Report of Special Study of the Securities Market, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 (1963). Exchange rules dealing with the employment relationship are designed to meet the problem upon which the Special Study focused. For example, Exchange rule 345 concerns itself not only with registration, but with training and competence. The Study described a wide range of practices ranging from good to no training at all, and concluded that the responsibility rested with individual firms. As respondent Ware admitted here (1 R. 170-171) he participated in the Merrill Lynch training program designed to fulfill the obligations of Rule 345¹⁹ and curb the abuses apparent not only in 1934 but as late as 1963. The purpose of investor protection is fulfilled by the very language of the RE-1 Form itself (1 R. 63-67), which obligates the employee to follow practices designed to protect the investor. The arbitration agreement is part of these obligations. (App. 55-56).

The Exchange, in its self-regulatory role, has a legitimate interest in deciding the manner in which disputes between its members and their employees are resolved, and in promoting harmonious relations among those persons and entities who have the operational role in dealing with the investing public. It is not unreasonable to require those

19. An explanation of the training program is set forth in the Exchange's supplementary information to Rule 345, see, *e.g.*, 2 CCH N.Y.S.E. Guide ¶ 2845.10-17.

engaged at that critical point to resolve their disputes by prompt and economic arbitration rather than drawn out litigation, *e.g.*, *Wilko v. Swan*, 346 U.S. at 431-32; *Prima Paint Corp. v. Flood & Conklin Mfg. Co. Inc.*, 388 U.S. at 404.

Although it has been said that arbitration is inappropriate for resolution of antitrust issues, *e.g.*, Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U.L.Rev. 1072 (1969), in the absence of concrete statistical analysis, this view is speculative. See *e.g.*, Aksen, *Arbitration and Antitrust: Are They Compatible?* 44 N.Y.U.L.Rev. 1097 (1969). The typical justification for judicial reluctance to utilize the arbitration process for such claims ignores reality. For example, if fraud in the inducement of a contract is a permissible issue to submit to arbitration, *e.g.*, *Prima Paint Corp. v. Flood & Conklin, Mfg. Co.*, 388 U.S. 395, there is no reason to believe that antitrust issues are not equally appropriate. Concern over limited discovery in arbitration is vitiated, at least insofar as the California Arbitration Act is concerned, which makes all statutory tools of civil discovery available in arbitration proceedings. See, *e.g.*, California Code of Civil Procedure §§ 1282.6, 1283, 1283.1. Concern that arbitrators are "not bound by rules of law," *e.g.*, *Wilko v. Swan*, 346 U.S. at 436-37, ignores the fact that arbitrators called upon to decide antitrust issues would presumably review applicable law. And the determination of the arbitrators would be reviewable to insure that a "manifest disregard" of the law has not occurred. *Wilko v. Swan*, 346 U.S. at 436; *Cf. Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 74). That arbitrators should decide the questions initially was the basis of the decision by the court of appeals in the *Frame* case. (App. 73-74). It obviously believed that arbitration of these issues was appropriate and did not offend any state policy. Finally, arbitration here offers an economical and workable vehicle for the resolution of issues requiring intimate familiarity

with features of the securities industry. Moreover, if the alleged restrictive practice is to fall, a decision by arbitrators to that effect is far more consistent with, and more meaningful to, the self-regulatory scheme than imposition of external controls.

Wilko v. Swan, 346 U.S. 427 (1953), does not suggest otherwise. There an investor, a member of the primary class of persons which the 1934 Act was designed to protect, had executed an arbitration agreement when he opened a margin account with the broker-dealer. The broker-dealer sought arbitration in an action for damages under section 12(2) of the Securities Act of 1933, Act of May 27, 1933, c. 38, § 12(2), 48 Stat. 74, 15 U.S.C. § 77 l. This Court held the arbitration agreement invalid relying primarily on the express Congressional intent in section 14 of the Act declaring any "stipulation" waiving compliance with the Act void. Section 14 is identical with section 29 of the 1934 Act. *Wilko* is predicated upon the special right to recover for misrepresentation. But it also recognized that arbitration of statutory rights was both possible and desirable. 346 U.S. at 432 & n. 13.

Respondents here are not investors. Moreover, as discussed in Part I of this Brief, section 28 of the 1934 Act carves out an exemption to the non-waiver provisions of section 29 insofar as the binding effect of Exchange rules designed to settle disputes is concerned. Unlike *Wilko* there is no express or implied Congressional intent to protect member-firm employees qua employees comparable to the non-waiver provisions in section 29, or any special right conferred upon them. Indeed, both section 6 and section 28 imply a Congressional intent to the contrary by authorizing Exchange rules such as Rule 347 (b) to be promulgated.

In *Wilko* this Court was concerned with the fact that Congress sought to stimulate and encourage private enforcement by public investors by giving them special statutory

rights with liberal choices of forum and ease of proof, 346 U.S. at 430-31. While section 16600 arguably imports the same concern on the state level, the additional liberality factors are not present.²⁰ Even if those considerations were present they are not diminished by arbitration. The Exchange rules permit arbitration in California, and Merrill Lynch has so agreed. (2 R., Exhibits D, E, F). In addition, factual resolutions are facilitated by arbitrations, as *Frame* noted. (App. 74).

The *Frame* court realized that *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 42 Cal.Rptr. 107 (1965), did not purport to change established California Code law interpreting section 16600. In addition to noting that issues of fact could appropriately be decided by arbitrators, it also referred issues of law to them, including the construction of Article 11.1 of the Plan. (App. 74). The *Frame* court undoubtedly had in mind cases like *Gordon v. Landau*, 49 Cal.2d 690, 321 P.2d 456 (1958), upholding an agreement not to use confidential customer lists for one year after termination of employment in the face of a challenge under section 16600. Other California cases make similar nonstatutory exceptions even though Business and Professions Code sections 16601 *et seq.* appear to be the exclusive exceptions. See generally Briody, *Employment Agreements Not To Compete In California*, 47 CAL. STATE BAR J. 318 (1972). These questions, as *Frame* recognized, are best resolved by industry arbitrators who are better equipped to evaluate Article 11.1 of the Plan because they are familiar with the circumstances involved and the nature of industry needs.

Although directed at the administrative process, Mr. Justice White's observations in *Ricci v. Chicago Mercantile Exchange*, U.S. at, 93 S.Ct., at 582, are relevant.

20. Section 16600 does not create any special forum for litigation, or simplify methods of proof, nor does it permit treble damages, although the same are permitted for other state antitrust violations, e.g., Business & Professions Code § 16750 (a).

In dealing with rules of the mercantile exchange, his opinion for the Court suggests that questions about the "scope, meaning and significance" of exchange rules should be initially decided by persons familiar with industry custom and practice. The same rationale applies here to the arbitration process, as perceived by the court of appeals in *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (App. 73-74).

A decision by this Court that Rule 347(b) must be followed by a California court does not necessarily foreclose judicial scrutiny of the antitrust claim, as the court of appeals noted in *Frame*. Its result is a striking parallel to this Court's decision in *Ricci*, as both Mr. Justice White and the Chief Justice noted, ____ U.S. at ____, ____, 93 S.Ct. at 582, 583-84.

The Court's opinion in *Silver* also does not require the result reached here. The application of *Silver* to an exchange rule of long standing²¹ is qualitatively different from its application to a single instance of enforcement. The *Silver* concern—a total lack of a forum—is not present here. The forum question should be viewed as a policy consideration, not a question of statutory construction. Congressional policy gave the Exchange authority to promulgate rules. Rule 347(b) has not "plainly exceeded" that authority, as *Silver* requires to overturn a rule, 373 U.S. at 365, and as such is entitled to enforcement over any conflicting state law, whether it be antitrust or otherwise. The frustrating effect of section 16600, as with section 229, takes the form of rendering meaningless the procedural provisions of the regulatory scheme. The broad grant of authority in section 6 indicates Congress wishes the exchange to have broad responsibility for the regulation of the industry more or less undisturbed by judicial policies on competition, arbitration, or conflicts between the two at

21. *Crimmins v. American Stock Exchange*, 346 F.Supp. 1256, 1271 (S.D.N.Y. 1972) (arbitration rules in force since 1934).

this particular level of federal-state relationships. To hold otherwise permits section 16600 to be the obstacle to the accomplishment and execution of the self-regulatory scheme in section 6.

III

Application of Business and Professions Code Section 16600 to the Employment Relationship and the Profit Sharing Plan Which Requires National Uniformity Unduly Burdens Commerce.

The Merrill Lynch Profit Sharing Plan operates on a national and international level, open to all eligible Merrill Lynch employees wherever located. (App. 49-50). Their employment was interstate in nature, as is Merrill Lynch's business, and their activities affect interstate commerce and contemplate use of the facilities of interstate commerce. See, e.g., *Prima Paint Corp. v. Flood & Conklin Mfg. Co., Inc.*, 388 U.S. at 401; *Dickstein v. DuPont*, 320 F.Supp. at 153. A number of states which have considered similar provisions under related state antitrust statutes or common law restraint of trade principles have upheld the legality of the provision, including New York whose law was intended to be the operable law for application. See, e.g., *Kristt v. Whelan*, 5 N.Y.2d 807, 155 N.E.2d 116 (1958).²² Others, like California, have held such provision illegal.²³ Under federal law, no court has yet construed such a provision to raise the issue of a Sherman Act violation. See, e.g., *Austin v. House of Vision, Inc.*, 404 F.2d 401 (7th Cir. 1968); *Graham v. Hudgins, Thompson, Ball & Assoc., Inc.*, 319 F.Supp. 1335 (N.D. Okla. 1970).

22. See also *Van Pelt v. Berefco, Inc.*, 60 Ill.App.2d 415, 208 N.E.2d 858 (1965) (applying Massachusetts law). Other states have upheld noncompetition clauses without discussion of restraint of trade principles, e.g., *Flynn v. Murphy*, 350 Mass. 352, 215 N.E.2d 109 (1966); *Stopford v. Boonton Molding Co.*, 56 N.J. 169, 265 A.2d 657 (1970); *Garner v. Girard Trust Bank*, 442 Pa. 166, 275 A.2d 534 (1971).

23. E.g., *Estate of Schroeder v. Gateway Transp. Co.*, 53 Wis. 2d 59, 191 N.W.2d 860 (1971) (statute permitting reasonable restrictions).

The net effect of the court of appeals decision requires Merrill Lynch to comply with the most stringent standard. The thrust of the court's decision is that while Merrill Lynch may still have a uniform plan, it must be a plan complying with California law. Such a plan would deprive Merrill Lynch of the benefits of the laws of the greater number of states in which the provision is legal, and of the right to insist that its personnel who have access to confidential business information or who develop close relationships with customers, and whom Merrill Lynch has trained, will not utilize such information or relationships in competition with Merrill Lynch. Even in those states where a similar provision has been held to be invalid under state law, the statute does not necessarily vitiate any provision. For example, the Wisconsin statute referred to in *Estate of Schroeder v. Gateway Transp. Co.*, 53 Wis.2d 59, 191 N.W.2d 860 (1971), permits reasonable restraints. Yet because of section 16600 Merrill Lynch is forced to have a plan complying with California law even though it may comply with not only laws of states which validate the provision generally but also those which validate it under limited circumstances.

Although the court below was concerned over the effect of its decision vis-a-vis non-California employees, Article 11.1 contains no intrastate limitations. Ware's benefits would have been forfeited and redistributed to other employees whether or not Ware entered into competitive employment in or out of California. Its operation is more than intrastate in nature, thus drawing into question the applicability of the state law.

The natural, rational result of the exercise of Congressional power under the federal antitrust laws is to avoid the development of multiple standards in measuring interstate violations. While states may legislate as to local trade, their power stops there. Cf. *United States v. Frank-*

fort Distilleries, 324 U.S. 293, 298 (1945). When the issue has been squarely raised, courts have uniformly and expressly rejected contentions that state antitrust laws apply to transactions involving interstate commerce. See, e.g., *Kosuga v. Kelly*, 257 F.2d 48 (7th Cir. 1958), *aff'd on other grounds*, 358 U.S. 516 (1959). This doctrine has also been followed in state courts, e.g., *Vendo Co. v. Stoner*, 105 Ill. App.2d 261, 245 N.E.2d 263 (1969); *State v. Milwaukee Braves, Inc.*, 31 Wis. 2d 699, 144 N.W.2d 1 (1969).

Section 16600 also is not the type of legislation where the "propriety of local regulation has been long recognized," as in health and safety statutes. *Southern Pac. Co. v. Arizona*, 325 U.S. at 796 (Douglas, J., dissenting). While it may promote legitimate state interests, even where a state pursues a clearly legitimate local interest the burden on interstate commerce may exceed permissible limits.

The employment agreement here, while primarily focused in California, was never expressly or impliedly so limited. As Congress itself realized when it enacted the securities legislation, interstate commerce is regularly used and vitally affected by broker dealers in servicing the investing public. That a registered representative is involved in such commerce is readily apparent. See, e.g., *Dickstein v. DuPont*, 320 F.Supp. at 153. Ware's employment was not the typical traditional state regulated local activity. He was expected to service Merrill Lynch clients wherever located and that activity clearly contemplated, as a minimum, use of interstate communication and travel facilities (*cf.* 1 R. 170-71). Compare *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. at 401. Since his employment was interstate in nature as to execution and performance, it cannot be tested by state standards. That relationship does not admit of diverse treatment since state and local law unduly burden the nature of the enterprise involved. See, e.g., *Flood v.*

Kula, 316 F.Supp. 280, 281 (S.D.N.Y. 1970), *aff'd*, 443 F.2d 264, 267 (2d Cir. 1971), *aff'd*, 407 U.S. 258, 284 (1972). Yet that is exactly the effect of the decision below on the Merrill Lynch plan.

Merrill Lynch recognizes that the existence of the power in the federal government to regulate interstate commerce under the Commerce Clause does not exclude all state regulation. See, e.g., *Southern Pac. Co. v. Arizona*, 325 U.S. 761, 766-67 (1945). But here, where the regulation of an ostensibly local matter is not local in effect and its impact on national commerce does interfere with its operation, the competing local demand should not be permitted to prevail. *Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959).

CONCLUSION

For the foregoing reasons it is respectfully submitted that the order and decision of the court below should be reversed.

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Appendix A

New York Stock Exchange Rule 345.

Employees—Registration, Approval, Records, Discipline.

Rule 345. (a) No member or member organization shall

(1) permit any person to perform regularly the duties customarily performed by a registered representative, unless such person shall have been registered with and is acceptable to the Exchange, or

(2) employ any registered representative or other person in a nominal position because of the business obtained by such person.

(b) No member corporation shall permit any person to assume the duties of an officer unless such corporation has filed an application with and received the approval of the Exchange.

(c) The Exchange may disapprove the employment of any person.

(d)(1) If the Exchange determines that any employee or prospective employee of a member or member organization (1) has violated any provision of the Constitution or of any rule adopted by the Board of Governors, (2) has violated any of his agreements with the Exchange, (3) has made any misstatement to the Exchange, or (4) has been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange, the Exchange may withhold, suspend or withdraw its approval of his employment by a member or member organization; may fine such employee or prospective employee \$5,000 for each such violation, misstatement, or act or omission for which he has been found guilty; and may direct that he be censured. The Exchange shall disclose publicly withdrawals of approval or suspensions of employees and former employees. The Exchange may in its discretion, disclose publicly censures

and fines, censures or fines. The total of the fines which may be imposed upon any employee or prospective employee at any one time shall not exceed \$25,000 except as provided in Rule 345(e).

(2) An accusation, charging a registered representative, non-registered employee or prospective employee with having committed a violation shall be in writing; it shall specify the charge or offense with reasonable detail and inform the person charged that he is entitled to request an appearance before a panel of the staff of the department bringing the charges. A copy of the charge or charges shall be served upon the person charged by delivering or by mailing it to him at his office address or at his place of residence. The person charged shall have ten days from the date of such service to answer the same, or such further time as the Exchange may deem proper. The answer and request for an appearance shall be in writing, signed by the person charged and filed with the department bringing the charge. A panel composed of three members of the department shall meet to consider the charge or charges. Notice of this hearing shall be sent to the said person charged; he shall be entitled to be present personally to examine and cross-examine all witnesses produced before said panel and also to present such testimony, defense, explanation or witnesses as he may deem proper. If said person charged should decline, refuse or neglect to request a personal appearance at this hearing, the determination of the panel shall be made on the basis of the charges and the written answer, if any, of the person charged. After hearing all witnesses and the person charged, if he desires to be heard, the panel shall determine whether the person charged is guilty of the offense or offenses. Notice of the finding and the penalty imposed by the Exchange and that such person may require a review by the Board of Governors in accord-

ance with Rule 345(e), shall be mailed to said registered representative, non-registered employee or prospective employee in the manner hereinbefore provided.

(e) Any present or prospective employee of a member or member organization may require a review by the Board of Governors of any determination and penalty made under this Rule by filing with the Secretary of the Exchange a written demand therefor within 20 days after such determination and penalty has been rendered. As a result of any such review the Board may sustain any determination and penalty imposed, may modify or reverse any such determination, and may increase, decrease or eliminate any such penalty, or impose any penalty, as it deems appropriate. The determination and penalty, if any, as approved by the Board following its review shall be final and conclusive.

(f) If any employee of a member or member organization is suspended or expelled from any other securities exchange or any national securities association, or is suspended or barred from being associated with any member of such exchange or association or is suspended or barred by any governmental securities agency from dealing in securities or being associated with any broker or dealer in securities, the Exchange may in view of such suspension, expulsion or bar, suspend or withdraw its approval of his employment by a member or member organization, but no such suspension by the Exchange shall commence before or expire after the suspension imposed by such other exchange, association or agency, and no such withdrawal of approval shall be imposed by the Exchange unless such employee has been expelled or barred by such other exchange, association or agency. Nothing in this paragraph (f) shall preclude any proceeding against any employee under Rule 345(d)(2). In any proceeding under this paragraph (f), the method of procedure required by Rule

345(d)(2) shall not apply, but the employee shall be given not less than ten days notice in writing of a hearing before a panel of the staff of the Exchange to determine whether or not the Exchange should suspend or withdraw, as the case may be, its approval of his employment of a member or member organization, as provided herein. At such hearing, the employee shall be afforded an opportunity to explain why it would be inappropriate for the Exchange to suspend or withdraw its approval of his employment, notwithstanding his suspension, expulsion or bar by such other exchange, association or agency. In the event the employee fails or refuses to appear at such hearing, the Exchange may nevertheless determine the matter and suspend or withdraw its approval of his employment as provided herein. Notice of the Exchange's determination and that such person may require a review by the Board of Governors in accordance with Rule 345(e), shall be mailed to such employee in the manner provided in Rule 345(d)(2).

. . .

New York Stock Exchange Rule 345.17

Agreements.—Each prospective registered representative or officer shall sign the following statements:

(a) "I authorize and request any and all of my former employers and any other person to furnish to the Exchange, or any agent acting on its behalf, any information they may have concerning my credit worthiness, character, ability, business activities, general reputation, mode of living and personal characteristics, together with, in the case of former employers, a history of my employment by them and the reasons for the termination thereof. Moreover, I hereby release each such employer and each such other person from any and all liability of whatsoever nature by reason of furnishing such information to the Exchange or any agent acting on its behalf.

"Further, I recognize that I will be the subject of an investigative consumer report ordered by the Exchange and that I have the right to request complete and accurate disclosure by the Exchange of the nature and scope of the investigation requested.

(b) I authorize the New York Stock Exchange to make available to any prospective employer, or to any Federal, State or Municipal agency, any information it may have concerning me, and I hereby release the New York Stock Exchange from any and all liability of whatsoever nature by reason of furnishing such information.

(c) I agree that the decision of the New York Stock Exchange as to the results, of any examinations it may require me to take will be accepted by me as final, and that I shall be subject to the penalties provided for under Rule 345(c) of the Board of Governors, as from time to time amended, if, in the opinion of the Exchange, I have

(1) violated any provision of the Constitution or of any rule adopted by the Board of Governors;

(2) violated any of my agreements with the Exchange;

(3) made any misstatements to the Exchange; or

(4) been guilty of (i) conduct inconsistent with just and equitable principles of trade, (ii) acts detrimental to the interest or welfare of the Exchange, or (iii) conduct contrary to an established practice of the Exchange.

(d) I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange as the same have been or shall be from time to time amended, and by all rules and regulations adopted pursuant to the Constitution, and by all practices of the Exchange."

Further, each registered representative, in consideration of the Exchange's approving his application, shall sign the following statements:

(A) "That I will not guarantee to my employer or to any other creditor carrying a customer's account, the payment of the debit balance in such account, without the prior written consent of the Exchange.

(B) That I will not guarantee any customer against loss in his account or in any way represent to any customer that I or my employer will guarantee the customer against such losses.

(C) That I will not take or receive, directly or indirectly, a share in the profits of any customer's account, or share in any losses sustained in any such account.

(D) That I will not make a cash or margin transaction or maintain a cash or margin account in securities or commodities, or have any direct or indirect financial interest in such a transaction or account, except with a member organization or with a bank. I understand and agree that no such transaction may be effected and no such account may be maintained without the prior consent of my employer, and that except for Monthly Investment Plan transactions such employer must receive promptly, directly from the carrying member organization or bank, duplicate copies of all confirmations and statements relating to such transactions or account. I further understand and agree that I shall receive no compensation for commissions or profits earned on any transaction or account in which I have a direct or indirect financial interest, except with the approval of my employer and in accordance with the rules of the Exchange.

(E) That I will not rebate, directly or indirectly, to any person, firm or corporation any part of the compensation I receive as a registered employee, and I will not pay such compensation, or any part thereof, directly or indirectly, to any person, firm or corporation, as a bonus, commission, fee or other consideration for busi-

ness sought or procured for me or for any member or member organization of the Exchange.

(F) That at any time, upon the request of the Department of Member Firms, or of any Committee or other Department of the New York Stock Exchange, I will appear before such Committee or Department and give evidence upon any subject under investigation by any such Committee or Department, and that I will produce, upon request of the Exchange, all of my records or documents relative to any inquiry being made by the Exchange.

(G) I understand that any changes in compensation in any form, or additional compensation in any form, may be subject to disapproval by the New York Stock Exchange, and that I may not be compensated for business done by or through my employer after the termination of my employment except as may be permitted by the Exchange.

(H) I agree that I will not take, accept, or receive, directly or indirectly, from any person, firm, corporation or association, other than my employer, compensation of any nature, as a bonus, commission, fee, gratuity or other consideration, in connection with any securities, commodities or insurance transaction or transactions, except with the prior written consent of the Exchange.

(I) I will notify my member organization and the Department of Member Firms promptly if, during the tenure of my employment I become the subject of: any investigation or proceeding by any governmental or securities or insurance industry self-regulatory body; a refusal of registration, injunction, censure, suspension, expulsion or other disciplinary action by any governmental or securities or insurance industry self-regulatory body; a major complaint by a customer of a member organization or by a broker-dealer in securities; a disciplinary action by a member organization; any litigation or arbitration alleging my violation of any agreement with or provision of any securities

industry self-regulatory body's constitution, by-laws, or rules or any securities or insurance law or regulation; or any bankruptcy or contempt proceeding, cease and desist order, injunction or civil judgment as party defendant; or any arrest, summons, arraignment, indictment, or conviction for a criminal offense (other than minor traffic violations); or any material allegation that I have conducted myself in a way which may be inconsistent with just and equitable principles of trade, or detrimental to the interest and welfare of the Exchange, or contrary to an established practice of the Exchange; or if I violate any provision of the Exchange Constitution or of any rule adopted by the Board of Governors or of any securities or insurance law or regulation or of any agreement with the Exchange.

(J) I agree that any controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedure prescribed in the Constitution and rules then obtaining of the New York Stock Exchange."

(K) If the Exchange, during the period of 90 days immediately following receipt by the Exchange of written notice of the termination of my employment gives me written notice that the Exchange is making inquiry into any specified matter or matters occurring prior to termination of such employment, I agree that I will thereafter, comply with any request of the Exchange for me to appear and testify, submit records, respond to written requests, attend hearings, and accept disciplinary charges or penalties with respect to the matter or matters specified in such notice in every respect in conformance with the Constitution, Rules and practices of the Exchange in the same manner and to the same extent as required to do if I had remained an employee. If I refuse to accept such written notice

or, having been given such notice, refuse or fail to comply with any such request of the Exchange, I agree that such refusal or failure may, in the discretion of the Exchange, act as a bar to future Exchange approval of my employment until such time as the Exchange has completed investigation into the matter or matters specified in such notice; has determined a penalty, if any, to be imposed against me; and until the penalty, if any, has been carried out.

New York Stock Exchange Rule 347.

Compensation.

Rule 347. (a) Pursuant to Section 1 of Article XV of the Constitution [¶ 1701], registered representatives may be compensated as follows:

(1) registered representatives—on a salary or a commission basis,

(2) branch office managers—on a salary or a commission basis: also, with the prior approval of the Exchange, they may receive a percentage of the net profit of the branch office,

(3) a registered representative who is also head of a department of the organization—may, with prior approval of the Exchange, receive a percentage of the net profit of his department, and

(4) bonuses—registered representatives may participate with the prior approval of the Exchange, in bonus distributions.

(b) Any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of any such party, in accordance with the arbitration procedure prescribed elsewhere in these rules.

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I

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

VS.

DAVID WARE, et al.,
Respondents.

**On Writ of Certiorari to the Court of Appeal of the
State of California for the First Appellate District**

RESPONDENTS' BRIEF

QUESTIONS PRESENTED

1. Whether the doctrine of federal preemption applies where a state law, permitting citizens of the state access to a judicial forum to settle private wage disputes with their employer, is invoked to negate application of a private arbitration agreement authorized by the rules of the New York Stock Exchange, when the state statute itself comports with similar federal legislation, and constitutes the implementation

of authority to an area over which the states have traditionally exercised jurisdiction.

2. Whether a state antitrust statute, declaring illegal any contract by which a person is restrained from engaging in a lawful occupation, as applied to a restraint of trade provision in a profit sharing plan of a national corporation constitutes an impermissible burden on interstate commerce where the forfeiture provision is not required by federal law or the laws of any other state and the effect of such antitrust law on the profit sharing plan is limited to the confines of the enforcing state.

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15:

§78f. Registration of national securities exchanges.

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce, so far as is within its powers, compliance by its members, with the provisions of this chapter, and any

amendment thereto and any rule or regulation made or to be made thereunder;

* * *

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

* * *

§78bb. Effect on existing law.

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

(b) Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect

on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this chapter or the rules and regulations thereunder.

§78cc. Validity of contracts.

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

California Business & Professions Code

§16600. Contracts void.

Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.

California Labor Code

§229. Maintenance of actions despite private agreement to arbitrate: Application of section.

Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement.

STATEMENT OF THE CASE

Respondent David Ware was employed by Merrill Lynch, on July 14, 1958, in San Francisco, California as an account executive. He continued to work for Merrill Lynch in San Francisco until March 17, 1969, when he voluntarily terminated his employment to accept a position with one of petitioner's competitors. (App. 45-46). By reason of accepting a competitive position, respondent forfeited all post-1960 wages credited to Ware's profit sharing fund by reason of Article 11.1 of the profit sharing plan. (App. 45-46; App. 38).

On January 19, 1970, Ware filed a class action suit in the California Superior Court claiming that the forfeiture provision was illegal as applied to California residents. (App. 2-7). Merrill Lynch filed its answer on April 17, 1970 and raised various defenses not one of which charged any respondent with theft of confidential business lists or breach of any fiduciary duty. (App. 45-50).

Petitioner did not request a restraining order of any type, or removal of the action to federal court. Rather it petitioned the state court for an order compelling arbitration by reason of arbitration clauses contained in the RE 1 Form and Rule 347(b) of the New York Stock Exchange Constitution. (App. 51-56).

The court denied the petition without comment and concomitantly therewith granted Ware's motion to allow the suit to proceed as a class action. (App. 57). Under California law, where the facts are not in dis-

pute, findings of fact and conclusions of law are not required. (App. 61).

A timely appeal was taken by Merrill Lynch wherein it asserted, inter alia, that the RE 1 Form was a valid contract; that no grounds existed under California law for the revocation of the arbitration agreement; that said agreement was not adhesive; and that the profit sharing plan's forfeiture provision, the underlying subject of any arbitration, was not illegal under state law. (1 R. Exh. A).

The California Court of Appeal affirmed,¹ holding that the forfeiture provision was illegal as applied to California residents pursuant to California Business & Professions Code §16600, and that Ware could not be compelled to arbitrate his claim by reason of California Labor Code §229 which preserves the right of employees to settle individual wage claims before the courts, notwithstanding private arbitration agreements to the contrary. (App. 57-68).

The California Supreme Court denied Merrill Lynch's petition for hearing without opinion. (2 R. Exh. I).

SUMMARY OF ARGUMENT

1. The Merrill Lynch forfeiture provision and the New York Stock Exchange Rule, 347(b) (even as construed by petitioner as requiring compulsory arbi-

¹This same court had previously held the forfeiture provision illegal in *Frame v. Merrill Lynch, Pierce, Fenner & Smith*, 20 Cal.App.3d 668, 97 Cal.Rptr. 811 (1971). Petitioner did not seek appellate review of that decision. (App. 69-74).

tration of wage disputes) are not mandated or even favored by federal policy:

(a) The language of 15 U.S.C. 78f(3)(c) commands that Exchange rules must comply with appropriate state legislation such as California Labor Code §229 as well as the directives contained in the Securities Exchange Act itself.

(b) Rule 347(b) constitutes an impermissible attempt by the Exchange to deprive respondents of their constitutional right to a trial by jury in violation of 15 U.S.C. §78f(a)(1), and Article VIII, of the Exchange constitution.

(c) The Exchange arbitration contract, Form RE-1, is a stipulation within the meaning of 15 U.S.C. §78cc, and is void by reason thereof. *Wilko v. Swan*, 346 U.S. 427 (1953); *Reader v. Hirsch & Co.*, 197 F.Supp. 111 (S.D. N.Y. 1961).

(d) The regulation of employer-employee wage dispute does not go to the heart of federal securities regulation. The conflicts presented in cases such as *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963) and *Thill Securities Corp. v. New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970), were much more directly within "... the general dimensions of the duty of self-regulation ... suggested by §19(b) of the Act, 15 U.S.C. §78s(b) ... " *Silver* at p. 352.

(e) The Securities and Exchange Commission does not have the authority to review or modify Rule 347(b). *Silver*, at pp. 372-373. Accordingly, it cannot be presumed that this rule has received acceptance either by the Commission or by Congress.

2. The legislative history of the Act of 1934, as well as specific provisions contained in the Act, such as 15 U.S.C. §78bb, indicate a Congressional intent that the states should exercise concurrent jurisdiction with the federal government over Exchange member activities not involving investor protection. Moreover, it is not a corollary of the existence of federal regulations in a field of commerce that a state's coexistent regulatory power is preempted. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).

(a) The federal courts are not disposed to attribute to Congress an intent to displace state laws which promote significant local policies. *Parker v. Brown*, 317 U.S. 341 (1943).

3. The California Legislation precluding compulsory arbitration of wage disputes in a non-collective bargaining context is consistent with the exclusionary provisions of 9 U.S.C. §1 (the Federal Arbitration Act). *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403 n.9 (1967) and 388 U.S. at p. 414 (dissenting opinion of Justice Black).

(a) The matter of employer-employee wage disputes is primarily one of local concern over which state courts have been given exclusive control. *Association of Westinghouse Salaried Employees v. Westinghouse Electric Corporation*, 348 U.S. 437 (1954).

(b) Individual arbitration hearings would provide an ineffective remedy in the present situation, given the class action aspects of the litigation and would defeat the implementation of the impor-

tant state policies reflected in *California Labor Code* Section 229 and *Business and Professions Code* 16600.

(c) The underlying subject of arbitration would be the issue of illegality of the Merrill Lynch forfeiture provision. Questions of illegality are not subject to arbitration. *Kelly v. Kosuga*, 358 U.S. 516 (1959).

4. The implementation of state antitrust policies such as Section 16600 is not prohibited by the existence of similar federal legislation. *Standard Oil of Kentucky v. Tennessee*, 217 U.S. 413 (1910).

(a) Neither the New York Stock Exchange nor its members have received Congressional immunization from antitrust sanctions, *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963); *Ricci v. Chicago Mercantile Exchange*, — U.S. —, 93 S.Ct. 573 (1973); *B.N.A. Securities Regulation and Law Report No. 190*, E.1-E.6, February 21, 1973.

(b) Important state policies, particularly in the field of antitrust, cannot be blunted through the arbitration process. *Aksen, Arbitration and Antitrust — Are They Compatible?* 44 N.Y.U.L. Rev. 1097 (1969), and the cases cited therein.

5. No state or federal law requires the forfeiture provision contained in Article 11.1 of the Merrill Lynch Profit Sharing Plan. Hence, Section 16600 does not interfere with or burden the interstate application of the profit sharing plan. In any event, the plan has been voluntarily discontinued by petitioner

as of October 1972, thereby obviating the need for this Court to pass on its uniformity argument.

(a) An impermissible burden on interstate commerce is not created by the mere fact that Merrill Lynch is subject to varying laws of different states. *Head v. New Mexico Board of Examiners in Optometry*, 374 U.S. 424, 428 (1963).

ARGUMENT

I

CALIFORNIA LABOR CODE §229 PRECLUDING COMPULSORY ARBITRATION OF INDIVIDUAL WAGE DISPUTES IS CONSISTENT WITH FEDERAL LAW; IN NO WAY INTERFERES WITH FEDERAL RULES AND POLICIES RELATING TO THE REGULATION OF SECURITIES; AND NEITHER FEDERAL LAW NOR THE RULES OF THE NEW YORK STOCK EXCHANGE OPERATE TO PREEMPT SUCH STATE LEGISLATION.

A. The application of California Labor Code §229 to the present controversy is compatible with federal securities legislation and is not preempted by such laws.

The State of California, like the federal government, recognizes that arbitration generally provides an efficacious means of resolving private commercial disagreements. However, both the California legislature, through Labor Code §229, and Congress in the Federal Arbitration Act, 9 U.S.C. §1 et seq., acknowledged that arbitration was an inappropriate vehicle to determine individual wage claims in situations where, by reason of their superior economic and negotiating strength, employers compel prospective employees not represented by collective bargaining

units, to sacrifice the privilege to settle future disputes through the judicial process in order to secure employment.

Moreover, the right of a wage earner to all lawfully due compensation is a matter of significant public concern, *City of Ukiah v. Fones*, 64 Cal.2d 104, 410 Pac.2d 369 (1966), which demands the protection of our impartial and independent judicial system with its attendant due process safeguards, as opposed to an employer-organized and controlled arbitration board such as that of the New York Stock Exchange, to which petitioner would have the present litigation referred.

The argument is made that this California legislation may not stand in the way of a New York Stock Exchange rule which would compel Merrill Lynch employees to arbitrate wage claims before an Exchange arbitration panel.² Petitioner suggests that Labor Code §229 is inconsistent with federal legislation governing the securities industry, but concedes, as it must, however, that the Securities Exchange Act does not mention arbitration, let alone command such a procedure as the means of settling disputes (Pet. Brief p. 22), and that the Act of 1934 was not intended to, and does not, preempt state legislation dealing with the regulation of securities dealers and registration of securities. (Pet. Brief pp. 19-20).

² Respondents' interest in the profit sharing plan clearly falls within the definition of "wages" under California law. See Calif. Labor Code §200; *Wise v. Southern Pacific Co.*, 1 Cal.3d 600, 607, 463 Pac.2d 426 (1970). Petitioner concedes that this interpretation is binding for purposes of the present dispute. (Pet. Brief p. 14).

The New York Stock Exchange rules compelling arbitration are not imprinted, ipso facto, with the seal of federal law. An exchange rule may be challenged and judicially invalidated as being beyond "... the great purposes of the Securities Exchange Act" especially when it deprives an individual of one of his most important constitutional rights. In such a case, the self-regulatory activity is "unjustified." *Silver v. N. Y. Stock Exchange*, 373 U.S. 341, 359 (1963).

The Securities Exchange Act was not designed to regulate wage disputes between an employer and employee. Rather, its purpose is "... to insure fair dealing and to protect investors ..." 15 U.S.C. §78f(d) or, as one observer states: "To afford a measure of disclosure to people who buy and sell securities; to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and to control the amount of the Nation's credit which goes into those markets." 1 *Loss, Securities Regulation*, 130-131 (2d Ed. 1961).

Congress has charged the courts with the responsibility of insuring compliance with its directives under the Act of 1934, not the Securities and Exchange Commission or the New York Stock Exchange. See for example, 15 U.S.C. §78aa, 15 U.S.C. §78i(e), 15 U.S.C. §78p(b) and 15 U.S.C. §78r(a). The Commission itself is not vested with jurisdiction to review or alter Exchange rules governing arbitration. *Silver*, at pp. 372 and 373; 15 U.S.C. §78s(b). It follows therefore that the imprimatur of Congress has not been

stamped on the arbitration policies of the New York Stock Exchange.

The New York Stock Exchange and Merrill Lynch would disregard in its entirety the command of Congress under the 1934 Act that no agreement shall be considered "... as a waiver of any constitutional right or any right to contest the validity of any rule or regulation." 15 U.S.C. §78f(a)(1).

This imperative as yet remains unconstrued by the courts. Not one case cited by Merrill Lynch has considered the application of this savings clause. Its mandate is clear. It has been observed in token fashion by the New York Stock Exchange in Article VIII of the Constitution preserving the right of all non-members of the Exchange to settle any controversy with petitioner in a courtroom rather than at an arbitration table unless the employees specifically elect otherwise.³

In ordering to arbitration a dispute between a non-member and an Exchange member at the election of the non-member, the Federal District Court in *Axelrod & Co. v. Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D. N.Y. 1970), Aff'd 451 F.2d 838 (2d Cir. 1971), specifically held that a *member*, by reason

³Merrill Lynch concedes respondents are non-members but asserts their classification is unimportant. (Pet. Brief p. 17).

Article VIII §6. "Any controversy between a non-member and a member or allied member or member firm or member corporation, arising out of the business of such member, allied member, member firm or member corporation or the dissolution of a member firm or a member corporation shall, at the instance of such non-member, be submitted for arbitration as provided hereinbelow."

of Article VIII of the New York Stock Exchange Constitution, could not compel a *non-member* to arbitrate. The Court, in *Azelrod*, was of the opinion the position of a party as a non-member was significant.

The New York Stock Exchange Constitution, like a state or federal constitution, would supersede and control those situations involving a conflict between a constitutional provision and a by-law or rule, such as Rule 347(b). Merrill Lynch cannot, therefore, compel its former non-member employees to arbitration against their will.

The waiver provisions contained in Rule 347(b) require arbitration of all disputes *in praesenti* or *in futuro*. No one can become a registered representative of the New York Stock Exchange without stipulating to waive, as a condition precedent of employment, the right to a judicial forum. (Pet. Brief pp. 11-12). *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D. N.Y. 1972).

The existence of written agreements to arbitrate future disputes between a customer and a member firm or between individuals dealing in securities has never given this Court difficulty. In *Wilko v. Swan*, 346 U.S. 427 (1953), an executory agreement to arbitrate between an investor and a broker was condemned as an unlawful waiver of the right to sue in court contrary to Section 14 of the Securities Act of 1933, 15 U.S.C. §77n. In so ruling, the Court held such an arbitration agreement was a stipulation within the meaning of §77n and, further, that executory agreements to arbitrate are treated with dis-

favor. To the same effect, *Shapiro v. Jaslow*, 320 F.Supp. 598 (S.D. N.Y. 1970); *Maheu v. Reynolds & Co.*, 282 F.Supp. 423 (S.D. N.Y. 1967); *Pawgan v. Silverstein*, 265 F.Supp. 878 (S.D. N.Y. 1967); *Reader v. Hirsch & Co.*, 197 F.Supp. 111 (S.D. N.Y. 1961).

In an effort to avoid this Court's criticism of such executory agreements, Merrill Lynch argues that when Ware signed the RE 1 Form in 1958 at the start of his employment, he agreed to arbitrate the present controversy which arose when he left in 1969. (Pet. Brief, pp. 33-34). Article 11.1 of the Profit Sharing Plan only forfeits those wages credited to the employee's account subsequent to the fiscal year ended December, 1960. (App. 38). This is so because the plan was amended in 1960 to include the forfeiture provision. Accordingly, the adhesive application signed by Ware in 1958 was executory in nature since no dispute existed at the time of his employment as to post-1960 earnings, and would be unenforceable by that fact alone. *Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209, 1215 (2nd Cir.), cert. denied, 406 U.S. 949 (1972).

The Court, in *Wilko*, limited its holding to a securities buyer-broker situation solely by reason of the express language contained in §77n, that any stipulation requiring "a person acquiring any securities" to waive in advance his right to select a judicial forum, is void and unenforceable.

Such a limitation was eliminated from the Securities Exchange Act of 1934, 15 U.S.C. §78cc(a) which

is the equivalent of §77n. Section 29 of the 1934 Act voids any stipulation "binding any person" to waive the right to a judicial hearing. It follows that Congress sought to redefine the perimeters of the Act's effectiveness to include within its protective boundaries employees and any other class of persons who deal with the Exchange and its members on unequal terms.

When faced with a similar statutory construction problem under the Federal Employers Liability Act, this Court chose to interpret such legislation in a manner that would protect the rights of individual employees against their more powerful employers. *Philadelphia, Baltimore & Washington R.R. Co. v. Schubert*, 224 U.S. 603, 611 (1912).

There is no logical reason why a non-member employee should be treated any differently from an investor since both are at similar disadvantage when faced with the superior economic power of the New York Stock Exchange and its members.

Within this context, California Labor Code §229 parallels the Congressional intent manifested in §77n of the Securities Exchange Act of 1933 and Sections 78f(a)(1), 78bb(a)(b) and 78cc(a) of the Securities Exchange Act of 1934, that the constitutional right of individuals to settle their grievances in a court of law will be respected and protected against infringement.

Congress, in enacting the Securities Acts of 1933 and 1934 created special federal rights which are sup-

plementary to "any and all other rights and remedies that may exist in law or at equity;". Section 28(a) of the Act of 1934, and Section 16 of the Act of 1933.⁴ Cf. 49 U.S.C. §1506, of the Federal Aviation Act. Before such federal legislation came into existence, the judicial remedies allowed a suitor were those created exclusively by state law which law continues to control as to violations outside the defined purposes of the 1934 Act. *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182-183 (2nd Cir. 1966) cert. denied, 385 U.S. 817 (1966).

The federal cases relied upon by petitioner do not support its Rule 347(b) argument.⁵ Rather, these decisions, under the questionable leadership of *Brown*, regrettably indicate a tendency on behalf of the lower federal courts to abdicate the judicial responsibilities placed upon them by the Constitution and by Con-

⁴15 U.S.C. §77p. "The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity."

⁵*Brown v. Gilligan, Will & Co.*, 287 F.Supp. 766 (S.D. N.Y. 1968), [arbitration required in member v. member situation]; *Coenen v. E. W. Pressprich & Co.*, 453 F.2d 1209 (2nd Cir. 1972), cert. denied 406 U.S. 949 (1972) [arbitration required in action by an allied member against a member firm]; *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838 (2nd Cir. 1971) [defendant non-member can voluntarily submit to arbitration and compel arbitration over objections of plaintiff-member firm]; *Revenue Properties Litigation Cases v. Cohn, Delaire & Kaufman*, 451 F.2d 310 (1st Cir. 1971) [both parties were broker-dealer members and arbitration was granted]; *Isaacson v. Hayden, Stone, Inc.*, 319 F. Supp. 929 (S.D. N.Y. 1970) [arbitration in member v. member dispute]; *Dickstein v. duPont*, 320 F.Supp. 150 (D.Mass. 1970), aff'd 443 F.2d 783 (1st Cir. 1971) [employee v. member]; *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D. N.Y. 1972) [employee v. member]; *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec.L.Rep. ¶93742, E.D. Pa. January 19, 1973) [allied member-member].

gress under the Securities Exchange Acts of 1933 and 1934, and a patent refusal to enforce the rulings of this Court, in *Wilko* and *Silver*, insofar as they apply to investor or non-member claims.

The *Brown* case involved the question of arbitrability of a dispute between two member firms of the American Stock Exchange (AMEX). The Rules of AMEX, like the rules of the New York Stock Exchange, require arbitration between members, but do not contain any waiver provision similar to Rule 347(b) which would require arbitration of non-member claims.

The Court, in *Brown*, without legal precedent, held that Section 28(b) of the 1934 Act, 15 U.S.C. §78bb(b) operated to preempt, as it were, the non-waiver provisions of Section 29(a), 15 U.S.C. §78cc(a), as well as Section 14 of the 1933 Act, 15 U.S.C. §77n, thereby overruling in essence *Wilko v. Swan*, *supra*.

There is absolutely no support for this position in the Congressional history of the 1934 Act. Such a ruling flies in the face of Supreme Court precedent as well as the clear wording of Section 28(b) that "nothing in this chapter shall be construed to modify existing law . . ." and that any action taken by the Exchange must be consistent with all other provisions of the 1934 Act.

Section 28(b) was not meant to apply in those situations which are violative of Section 29(a), 15 U.S.C. §78cc and Section 6(a)(1), 15 U.S.C. §78f(a)(1).

Further, such a construction directly conflicts with the grant of judicial jurisdiction contained in Section 27, 15 U.S.C. §78aa and Section 22 of the 1933 Act, 15 U.S.C. §77v.

Cases such as *Coenen, Revenue Properties Litigation Cases*, *Brown*, *Isaacson* and *Ayres* all involved member disputes which, as recognized in *Azelrod*, are treated differently from employee situations under Section VIII of the Exchange Constitution. With the exception of *Rust v. Drexel Firestone, Inc.*, 352 F.Supp. 715 (S.D. N.Y. 1972), not one case considered the interaction of state law.

In *Rust*, an employee-employer dispute, the District Court compelled arbitration against the defense of duress on the grounds that plaintiff had failed to establish duress and, further, that the New York Stock Exchange requirement of compulsory arbitration did not conflict with the legislative policy of the State of New York, Rust's domicile. In *Ware*, California has deemed it important to its local public policy to protect its citizens from such compulsory arbitration.

Certainly, a sovereign state's interest in the welfare of its citizens is more pervasive than that of the New York Stock Exchange. In addition, the Court, in *Rust*, mistakenly relied on *Dickstein* as holding that the Securities Exchange Act immunizes the RE 1 Form arbitration clause from antitrust attack. On the contrary, the Court in both *Dickstein* and *Coenen* recognized that if more than perfunctory antitrust

claims had been pleaded, neither dispute would be subject to arbitration.

The construction placed upon the meaning of Section 29(b) by *Brown* and its progeny represents a marked departure from such cases as *Boyd v. Grand Trunk Western R.R. Co.*, 338 U.S. 263 (1949); *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697 (1945); *Duncan v. Thompson Trustee*, 315 U.S. 1 (1942); and *Philadelphia, Baltimore & Washington R. R. Co. v. Schubert*, 224 U.S. 603 (1912), wherein this Court struck down under other federal statutes agreements that would limit an individual's choice of forum, or constitute a waiver of his right to bring a lawsuit.

This Court, however, need not choose between enforcement of the California legislation challenged and the policies of the Securities Act, for the application of the relevant California statutes in the present context is in no way inconsistent with federal securities regulation, and not preempted thereby.

The important state interests promoted by §229, especially in combination with California Business and Professions Code §16600, the other statute challenged by petitioner, are to protect employees in their right to work and to pursue lawful trades and professions irrespective of employer attempts to impose restrictions on their job mobility (§16600); and to preserve the right of individual employees to utilize judicial remedies to collect due and unpaid wages irrespective of employer attempts to compel arbitration of wage claims.

In advancing its preemption argument, petitioner relies on *Perez v. Campbell*, 402 U.S. 637 (1971) and *Hines v. Davidowitz*, 312 U.S. 52 (1941). Neither of these cases is even remotely connected to the problem of reconciling federal securities policy with state legislation. In fact, not one single case has been cited in which a state statute has been held preempted by federal securities legislation.

In *Perez*, this Court invalidated an Arizona "financial responsibility" law because it was inconsistent with the Federal Bankruptcy Act. The Arizona statute provided that a discharge in bankruptcy would not relieve the debtor of the state's statutory requirements. In effect, Arizona law directly conflicted with federal bankruptcy policy in favor of giving debtors "... 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.'" 402 U.S. 637, at 648.

In *Ware*, the California statute precluding compulsory arbitration of employer-employee wage disputes does not jeopardize any federal securities policy. Indeed, Congress has adopted a similar exclusionary provision for disputes concerning employees who are engaged in interstate commerce. 9 U.S.C. §1. There is no indication whatsoever that Congress intended to exempt the securities industry from this general provision. To paraphrase Justice Frankfurter in his dissenting opinion in *Textile Workers v. Lincoln Mills*, 353 U.S. 448 (1957), nothing pertaining to the 1934 Act suggests vesting the New York Stock Exchange

with sweeping power under the commerce clause or the Securities Act comparable to that vested in the federal courts under the bankruptcy power. *Id.* at 484.

In *Perez*, this Court's preemption decision was based, in part, on the necessity of uniform federal regulation in the field of bankruptcy. 402 U.S. at pp. 655-656. In contrast, there is no similar interest in uniformity in our present case. Moreover, with respect to industry self-regulation, federal law requires stock exchange rules must be consistent with appropriate state laws. 15 U.S.C. §§78f(c), 78bb(a).

For these same reasons, reliance on *Hines v. Davidowitz, supra*, is likewise misplaced. In that case, a state law regarding aliens was held invalid because of its interference with federal regulations. Unlike the present situation, the control of aliens was found to be a matter of predominant federal concern. The state's interest was minimal at best.

A closer analogy to *Ware* may be found in *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963) where federal legislation sought to ensure the maturity of avocados reaching retail markets. The federal standards were promulgated, in part, by an industry governing body. 373 U.S. at p. 138. Thus, as in our case, there existed general federal regulations and more specific industry self-regulatory rules adopted under the supervision of the federal government. The Florida growers complied with these federally-related standards and with the rules adopted by the industry but not with the more restrictive California state requirements. In its decision, this Court held that the more stringent California regu-

lations were *not* preempted by either federal regulations or the industry rules. As Mr. Justice Brennan stated [373 U.S. at p. 142]:

"... federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained. See, e.g., *Huron Portland Cement Co. v. Detroit*, *supra*." [362 U.S. 440].

In *Ware*, as in *Florida Growers*, Congress established minimum standards of fair dealing for the industry. Congress expressly authorized continuing state regulation. Mr. Justice Brennan observed, "The maturity of avocados seems to be an inherently unlikely candidate for exclusive federal regulation. Certainly it is not a subject by its very nature admitting only of national supervision. Cf. *Cooley v. Board of Port Wardens*, 12 How. 299 . . ." 373 U.S. at pp. 143-144.

This is equally true of problems regarding employer-employee wage disputes, an even more local interest which is within the state's power to regulate as California has through Labor Code §229. Wage disputes, even in the securities industry, are not subjects demanding exclusive federal regulation. There has been no showing that national uniformity in the area of wage claims is vital to federal securities policy or to the national interest. Compare *San Diego Building Trades Council v. Garmon*, 359 U.S. 236 (1959) and *Florida Growers, supra*, 373 U.S. at p. 144.

The dissenting opinion by Mr. Justice White in the *Florida Growers* case was based on the view that the federal government, not a private corporation, had attempted to define a national and uniform standard of maturity of avocados in order to facilitate marketing in interstate commerce, and that the California statute interfered with this necessary interstate standard of uniformity. 373 U.S. at pp. 165-166. The dissenters found that the conflict between federal and state law was "unmistakable." 373 U.S. at p. 173.

By contrast, no such conflict is even remotely definable herein. The California statute precluding compulsory arbitration of wage disputes does not interfere with or even relate to federal policy concerning protection of investors. Clearly, state law has not "... erected a substantial barrier to the accomplishment of Congressional objectives," *Florida Growers*, 373 U.S. at p. 167 (dissenting opinion).

In short, there is no evidence in federal securities laws or their legislative history which would indicate that Congress intended to supplant state regulation. On the other hand, there is every indication that Congress anticipated and intended for a broad range of state laws including those such as California's Labor Code §229 to govern private businesses within the securities industry. Under these circumstances, a finding of preemption cannot be made. *Colorado Anti-Discrimination Commission v. Continental Air Lines, Inc.*, 372 U.S. 714 (1963); *Head v. New Mexico Board of Examiners in Optometry*, 374 U.S. 424 (1963).

Sovereign states have the prerogative to establish legislative policies protecting employees' rights as against economically more powerful employers. *Lincoln Federal Union v. Northwestern Iron & Metal Co.*, 335 U.S. 525 (1949); *Day-Brite Lighting, Inc., Compco Corp., v. Missouri*, 342 U.S. 421 (1952); *Brotherhood of Locomotive Firemen & Enginemen v. Chicago, Rock Island & Pacific Railroad Co.*, 393 U.S. 129 (1968).

The Securities Exchange Act, itself, recognizes that the policy permitting limited self-regulation is subject to restriction. In 15 U.S.C. §78f(c), Congress has allowed a stock exchange to adopt and enforce its own rules so long as such rules are "... not inconsistent with ... the applicable laws of the state in which it is located."

Stock exchange rules must correspond to all appropriate federal and state legislative policies. Members of the New York Stock Exchange (and the Exchange itself, through its member firms) are clearly "located" in the State of California. The Exchange and its member firms engage in vast amounts of business on a regular basis in California. Merrill Lynch has twenty-three offices in California and is a member of the Pacific Coast Stock Exchange whose principal office is physically located in San Francisco, California.

The arbitration rules of the Pacific Coast Stock Exchange, like Article VIII of the New York Stock Exchange Constitution, provide that non-member employees cannot be compelled to arbitrate unless they

themselves make such an election. No waiver provisions similar to Rule 347(b) are in effect.^a

Since Merrill Lynch is a member not only of the New York Stock Exchange but also of the American Stock Exchange, Pacific Coast Stock Exchange and other exchanges located in various states, its uniformity thesis becomes immediately discredited. To use petitioner's own argument, it must comply with the laws of the state in which the exchange is located. Hence, it must obey California law as well as the law of the other states in which it holds exchange membership.

In the case of *Parker v. Brown*, 317 U.S. 341 (1943), a state directed that producers of raisins combine to restrict the supply of raisins being shipped to interstate markets. The action of the raisin producers would have been a clear violation of federal antitrust laws if carried out solely by private individuals (317 U.S. at p. 350). Moreover, there was no indication in the Sherman Act or any other federal statute that the states were authorized to pass regulations inconsistent with the national policy of free and open competition.

^a*Article VIII Arbitration of Claims, Non-Member Claim*

Sec. 2. Any other claim by a member or non-member against a member or member firm may be submitted to arbitration pursuant to the Rules of the Exchange by agreement of the parties.

CCH Pacific Coast Stock Exchange Guide, ¶1806.

Rule XII Arbitration of Claims of Non-Members

Sec. 1. Any person not a member of the Exchange shall have the right to make a demand against a member of the Exchange arising from any Exchange transactions upon the following conditions.

CCH Pacific Coast Stock Exchange Guide, ¶5300.

Despite these considerations, this Court ruled that the power of the state to enact legislation to protect the welfare of its citizens and to preserve its local industry (317 U.S. at p. 346) was beyond the reach of federal antitrust legislation. In *Parker*, the state raisin proration program

"... derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command. We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress." 317 U.S. at pages 350-1 (Emphasis added).

The emphasis in *Parker* on the presumed intent of Congress not to supplant state laws promoting important local policies has been consistently followed. See *Allstate Insurance Co. v. Lanier*, 361 F.2d 870 (4th Cir. 1966); *E. W. Wiggins Airways, Inc. v. Massachusetts Port Authority*, 362 F.2d 52 (1st Cir. 1966); *Washington Gas Light Co. v. Virginia Electric & Power Co.*, 438 F.2d 248 (4th Cir. 1971).⁷

⁷Another line of cases such as *George R. Whitten, Jr., Inc., v. Paddock Pool Builders, Inc.*, 424 F.2d 25 (1st Cir. 1970) and *Travelers Insurance Co. v. Blue Cross of Western Pennsylvania*, 298 F.Supp. 1109 (W.D.Pa. 1969) uphold application of federal antitrust statutes on the ground that the state action there involved was not intended to displace the federal policy favoring free and open competition.

If this Court would presume an intent on the part of Congress not to preempt state laws—even when such state laws seem to conflict with a national interest as significant as the policy favoring competition^{*}—then state laws protecting employees of brokerage houses and stock exchanges must be respected. Moreover, there are numerous state laws which more directly regulate and affect the securities business (as to issuing stock, licensing brokers, etc.) than the mere regulation of employer-employee relationships involved in the present case. See *I Loss, Securities Regulation*, Chapt. I (2d Ed., 1969 Supp.).

In its landmark and frequently re-affirmed decision in *Silver*, this Court refused to find that federal securities legislation displaced other types of statutory regulation of stock exchanges or their members.

"The Securities Exchange Act contains no express exemption from the antitrust laws or, for that matter, from any other statute."

373 U.S. at p. 357.

The Court went on to rule, with particular reference to the applicability of antitrust regulations to the securities industry that repeal of otherwise valid legislation "... is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." Using this same approach in *Ware*, it becomes readily apparent that neither the wage forfeiture provision in

^{*}In *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958) this Court recognized that federal antitrust laws were designed to promote free and open competition as a means of advancing fundamental "economic liberty."

Merrill Lynch's profit sharing plan nor the compulsory arbitration rule (as applied to wage disputes) of the New York Stock Exchange are "... necessary to make the Securities Exchange Act work." *Silver, supra*, 373 U.S. at pp. 357-360. Thus, these private rules cannot be held to repeal or avoid valid state Legislative policies.

The employer-employee dispute here is even further removed and less significant, from the perspective of federal securities policy, than the cut-off of wire connections in *Silver* or the rate discrimination in *Thill Securities Corp. v. New York Stock Exchange*, 433 F. 2d 264 (7th Cir. 1970). Indeed, *Ware* is really outside the "general dimensions of self-regulation suggested by §19 of the Act, 15 U.S.C. §78s(b) ..." *Silver*, 373 U.S. at p. 352.

Employees, like investors, are not sufficiently protected by the arbitration procedures before the exchange.*

"By providing no agency check on exchange behavior in particular cases, Congress left the regulatory scheme subject to 'the influences of ... [improper collective action] over which the Commission has no authority but which if proven to exist can only hinder the Commission in the tasks with which it is confronted,' " *Silver v. New York Stock Exchange*, 373 U.S. at pp. 358, 359 (1963).

In fact, this Court recognized in *Silver* the complete absence of due process safeguards in the Exchange's

*There is no right to discovery. The arbitrators are selected from panels of the Exchange or members of the Board of Arbitration selected by the Exchange and the decision of the majority of arbitrators is final. Art. VIII §6, Rules of the Exchange 481-491.

dealings with non-members, *id.* at 363. Implicit in that opinion was a rejection of any suggestion that the arbitration process provided in Rule 347(b) met due process requirements, *id.* at 354.

The recent Senate Sub-committee eighteen-month investigation into the securities industry confirms that the New York Stock Exchange has done nothing to comply with the *Silver* mandate. "With respect to proceedings involving non-members, the principal exchanges, in the ten years since the Supreme Court's decision in the *Silver* case, have failed to provide non-members against whom they take actions, with the procedural safeguards which the Court in that case found essential. The Exchange Act should therefore be amended to require all self-regulatory organizations to adopt procedures which will afford constitutionally adequate due process to non-members directly affected by their actions." B.N.A. *Securities Regulation and Law Report* No. 190, E-4, February 21, 1973.

B. California Labor Code §220 is consonant with federal law.

The opinion of the California Court of Appeals in *Ware* represents application of the traditional state remedy afforded an employee in a wage dispute with his employer, in keeping with *Association of Westinghouse Salaried Employees v. Westinghouse Electric Corporation*, 348 U.S. 437 (1954), where this Court rejected an employee's group claim for unpaid wages under §301 of the Labor Management Relations Act by holding that the federal courts lack jurisdiction over such a suit. "The employees have always been

able to enforce their rights in the state courts" (Footnote omitted, *id* at p. 460).

If Congress, as was recognized in *Westinghouse* did not confer federal jurisdiction over employee wage claims by specific legislation in the labor field, then Merrill Lynch's unsupported argument that it was the intent of Congress to confer federal jurisdiction over such disputes by the enactment of the Securities Exchange Act of 1934, becomes all the more incredulous.

The state court's decision in *Ware* finds more than coincidental and parallel support in federal arbitration law. For example, 9 U.S.C. §1 of the Federal Arbitration Act contains similar exclusionary language to Labor Code §229: "... but nothing herein contained shall apply to contracts of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce." (Emphasis added). The Act was designed to exclude from within its framework, "... categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power ..." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403, n.9 (1967), such as the respondents' situation in this case. In order to work in the securities business, an applicant must sign the RE-1 form or look for a job in a different industry. *Ayres v. Merrill Lynch*, OCH Fed. Sec. Law Rep. 193742 (E.D., Pa. 1973).

In his dissenting opinion, in *Prima Paint*, Justice Black spelled out the legislative intent behind §1 of the Federal Arbitration Act. "Senator Walsh cited

insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers and employees. He noted that such contracts "are really not voluntarily [sic] things at all 'because' there is nothing for a man to do except sign it; and then he surrenders his right to have his case tried by court . . ." He was emphatically assured by the supporters of the bill that it was not their intention to cover such cases." *Id.* at p. 414. (Footnotes omitted). See also *United Electrical Radio and Machine Workers v. Miller Metal Products, Inc.*, 215 F.2d 221 (4th Cir. 1954).

Labor Code §229, like the exclusionary provisions of 9 U.S.C. §1, was enacted to prevent superior, commercial and industrial interests from taking advantage of individual employees who do not have bargaining rights comparable to labor unions which are exempted from the operation of §229. Without judicial intervention and legislative immunization, individual employees could be compelled to arbitrate disputes, in some instances, many thousands of miles away from their homes, and under less than neutral conditions. *Player v. Geo. M. Brewster & Son, Inc.*, 18 Cal. App. 3d 526, 96 Cal.Rptr. 149 (1971). Such arbitration agreements could amount to a denial of due process of law. *Prima Paint, supra*, at p. 407. (Dissenting opinion of Justice Black).

The right of respondents to a judicial determination of their claim for rightfully due compensation, not-

withstanding the existence of an alleged agreement to arbitrate, was decided by the California Court pursuant to the command of controlling state law, notwithstanding the New York choice of law provision in the profit sharing plan. All of the significant contacts between employer Merrill Lynch and the respondent employees occurred in California. Merrill Lynch maintains and operates twenty-three offices in California where respondents were employed and performed their duties. "... no state is bound to recognize or enforce contracts which the government of such state may deem injurious to its own interests, or to the welfare of its own people, or which are in violation of its own laws." *Davis v. Jointless Fire Brick Co.*, 300 Fed. 1, at p. 4 (9th Cir. 1924); *Buskuhl v. Family Life Ins. Co.*, 271 Cal.App.2d 514, 521, 76 Cal. Rptr. 602 (1969).

The decision to apply California law lies within the exclusive jurisdiction of the state courts. *Allen v. Alleghany Co.*, 196 U.S. 458 (1905).

Contrary to suggestions in petitioner's brief, respondents do not seek to undermine the use of arbitration as a means of resolving legal disputes.

It is inconceivable that Merrill Lynch can suggest that the arbitration process will result in economy of time and money where 100 or more members of the class would be relegated to as many separate and individual arbitration hearings. Without a class action vehicle, petitioner can effectively avoid a major state policy and the rights of each individual, as it would

be impractical for each respondent to pursue a separate action using the likely ineffective remedy of arbitration.

" 'Modern society seems increasingly to expose men to . . . group injuries for which individually they are in a poor position to seek legal redress, either because they do not know enough or because such redress is disproportionately expensive. If each is left to assert his rights alone if and when he can, there will at best be a random and fragmentary enforcement, if there is any at all. This result is not only unfortunate in the particular case, but it will operate seriously to impair the deterrent effect of the sanctions which underlie much contemporary law.' Kalvan and Rosenfield, *Function of Class Suit*, 8 U. Chi. L. Rev. 684, 686 (1941);"

Vasquez v. Superior Court, 4 Cal.3d 800, 807, 484 Pac. 2d 964 (1971).

Merrill Lynch recognizes as did this Court in *Bernhardt v. Polygraphic Co. of America, Inc.*, 350 U.S. 198 (1956) that arbitration is "outcome determinative".

"The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result." *Bernhardt* at p. 203.

Merrill Lynch purposefully acquiesced in the ruling of the California courts in *Frame v. Merrill Lynch*, 20 Cal.App.3d 668, 97 Cal. Rptr. 811 (1971), invalidating the forfeiture provision in Article 11.1 of its profit

sharing plan.¹⁰ No petition for review was filed with either this Court or the California Supreme Court.

It did so with knowledge that Article VIII, Section 6 of the New York Stock Exchange Constitution requires arbitration of the present dispute in New York City, and that arbitrators are not bound to follow precedent or the law. *Loevinger, Antitrust Issues as Subjects of Arbitration*, 44 N.Y.U.L. Rev. 1085 (1969); *Aksen, Arbitration and Antitrust—Are They Compatible?* 44 N.Y.U.L. Rev. 1097 (1969). Under California law, the *Frame* Court did not and could not compel arbitration in California thereby losing jurisdiction to enforce its decision. *California Code of Civil Procedure* §1293; *Weiman v. Superior Court*, 51 Cal.2d 710, 712, 336 Pac.2d 489 (1959). Moreover, New York arbitrators would not be duty bound to follow the decisions of the California courts in either *Ware* or *Frame*.

Petitioner's wholesale reliance on *Frame* is totally misplaced. The *Frame* decision was based on an erroneous interpretation of Rule 347(b). Not only did the *Frame* Court fail to consider Article VIII of the Exchange Constitution, it omitted any discussion of the interaction of federal statutory law, 15 U.S.C. §§78f(a)(1), 78bb(a) and 78cc on the waiver provision. Further, California Labor Code §229 was not even

¹⁰Having accepted the ruling in *Frame* that its forfeiture clause was illegal under §16600, petitioner would seem to be foreclosed by the doctrine of collateral estoppel from asserting a contrary position in this case. *Bernhard v. Bank of America, N.T. & S.A.*, 19 Cal.2d 807, 122 P.2d 892 (1942); *Blonder-Tongue Lab., Inc. v. University of Illinois Found'n*, 402 U.S. 313 (1971).

mentioned. The *Frame* decision likewise is contrary to the weight of established California and federal law regarding the non-arbitrability of questions of illegality.

Questions of illegality in California are not subject to the arbitration process despite agreements to the contrary. *Alpha Beta Mkts. v. Amal. Meat Cutters*, 147 Cal.App.2d 343, 350, 305 P. 2d 163 (1956).

The mandate of the California Supreme Court is unequivocal:

"The laws in support of a general public policy and in enforcement of public morality cannot be set aside by arbitration, and neither will persons with a claim forbidden by the laws be permitted to enforce it through the transforming process of arbitration.' . . . To hold otherwise would be tantamount to giving judicial approval to acts which are declared unlawful by statute . . ." (Citations omitted.)

Loving & Evans v. Blick, 33 Cal.2d 603, at pp. 611, 612, 204 P.2d 23 (1949).

The ruling of *Loving & Evans* is remarkably similar to that of this Court in *Kelly v. Kosuga*, 358 U.S. 516 (1959), wherein it was held that the courts would not enforce an illegal contract where it is obvious such action would " . . . make the courts a party to the carrying out of one of the very restraints forbidden . . ." at p. 520.

Merrill Lynch, in its opening brief before the California Court of Appeal, conceded that if that Court found the forfeiture provision illegal, arbitration would be precluded. (2R. Exh. A, p. 55).

Neither the holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403, n.9 (1967), nor Section 301(a) of the Labor Management Relations Act of 1947 are instructive in the context of this lawsuit.

Prima Paint was commenced in a federal court by reason of diversity.¹¹ The Court at p. 405 restricted its ruling to the narrow ground of "... how federal courts are to conduct themselves ..." when confronted with an arbitration agreement involving interstate commerce. Further, the issue in *Prima Paint* related to fraud in the inducement of the underlying agreement rather than to illegality and antitrust violations, which are deemed valid defenses to arbitration.

Section 301(a) of the Act of 1947 applies only to arbitration agreements contained in collective bargaining agreements and is irrelevant to this controversy. Those labor agreements are independently enforced under §301 without reference to the Federal Arbitration Act. *General Electric Co. v. Local 205, et al.*, 353 U.S. 547 (1957). *Textile Workers v. Lincoln Mills*, 353 U.S. 448 (1957).

¹¹Merrill Lynch cannot remove *Ware* at this juncture of the case in light of the mandatory provisions of 28 U.S.C. §1446(b). Merrill Lynch was served on January 27, 1970 and its answer filed April 17, 1970. (1 R. 51)

II

CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 16600 DOES NOT INTERFERE WITH FEDERAL POLICIES CONCERNING THE REGULATION OF THE SECURITIES INDUSTRY.

Article 11.1 of the Merrill Lynch profit sharing plan provides that an employee's interest in the profit sharing trust, whether vested or not, shall be forfeited if he voluntarily terminates his employment and accepts a position with a Merrill Lynch competitor, anywhere in the world within six months of such termination. (App. 38).

Under California statutes, such a forfeiture provision constitutes an unlawful restraint on an individual employee's right to engage in a lawful profession. *Muggill v. Reuben H. Donnelly Corp.*, 62 Cal.2d 239, 398 P.2d 147 (1965); *Frame v. Merrill Lynch*, 20 Cal. App.3d 668, 97 Cal. Rptr. 811 (1971); *Davis v. Jointless Fire Brick Co.*, 300 F. 1 (9th Cir. 1924). The *California Business and Professions Code*, §16600, is very specific:

"Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." (Emphasis added)

Merrill Lynch argues that §16600, as well as §229, must be ruled invalid as applied to employers in the securities industry. Merrill Lynch is asking this Court to determine that the California statutes are unconstitutional as applied to its dealings with its employees. The real issue, then is whether Congress in enacting

federal securities legislation meant to preempt state legislation of the type here involved. Congress had no such intent.

The policy of open competition is a significant interest which the State of California has the power and right to promote. Federal antitrust legislation does not preclude complementary and supplementary state regulation. *Standard Oil Co. of Ky. v. Tennessee*, 217 U.S. 413 (1910); *Waters-Pierce Oil Co. v. Texas*, 212 U.S. 86 (1909).

Indeed, it has been recognized that some problems concerning protection of competition are best left to state regulation. *Stern, A Proposed Uniform State Antitrust Law: Text and Commentary On a Draft Statute*; 39 Texas L. Rev. 717 (1961). This would be particularly true in a case such as this one which deals with anti-competitive restraints on an individual's pursuit of his lawful trade or profession. Here, vigorous state antitrust enforcement is a valuable complement to federal antitrust policy. *Stern, supra*, 39 Texas L. Rev. at pp. 718-719. *Blake, Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 628, n. 8 (1960).

Clearly, Article 11.1 of Merrill Lynch's profit sharing plan is designed to discourage its employees from going to work for competing firms.¹² Merrill Lynch

¹²Whether this provision violates federal antitrust laws is collateral. The contract unquestionably violates the California law protecting the mobility of employees' right to work and prohibiting anti-competitive restrictions on employment mobility. *Muggill v. Reuben H. Donnelly Corp., supra*. Moreover, in its Petition for Writ of Certiorari (Pet. Brief, pp. 13-14), Merrill Lynch concedes that five of its competitors in the securities field have similar re-

conceded this to be one of its purposes in its Petition for Writ of Certiorari (Petition, pp. 12-13.) There can be little doubt that the plan has had the intended effect. Merrill Lynch employees are seriously handicapped from taking competing jobs within the industry by threat of forfeiture of substantial vested financial interests.

The first question for the Court is whether the policy of free and open competition (mobility of brokers and employees among competing firms) in any way interferes with federal regulation of the securities industry. The starting point for resolving this issue " . . . is an analysis which reconciles the operation of both statutory schemes with one another rather than holding one completely ousted." *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963).

"The Securities Exchange Act contains no express exemption from the antitrust laws or, for that matter, from any other statute. This means that any repealer of the antitrust laws must be discerned as a matter of implication, and '[i]t is a cardinal principle of construction that repeals by implication are not favored' *Repeal is to*

restrictions on employees. If all six firms have combined and conspired to establish a device for the anti-competitive restriction of broker-employee services, such would constitute a violation of federal antitrust statutes. (Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§1, 2). Similar plans have been held contrary to the Sherman Act in *Anderson v. Shipowners' Ass'n. of Pacific Coast*, 272 U.S. 359 (1926) and *Union Circulation Co. v. Federal Trade Com'n*, 241 F.2d 652 (2nd Cir. 1957) where the Court noted, "Under the Federal Trade Commission Act, industry agreements and practices have been enjoined without an actual showing of injury to competition in order to extinguish monopolistic practices before injury occurs. See *Fashion Originators' Guild of America, Inc., et al. v. F.T.C.*, 1941, 312 U.S. 457, 468, . . .; *F.T.C. v. Raladam Co.*, 1931, 283 U.S. 643. . . ." at p. 657.

be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes." (Emphasis added) (Citations omitted) 373 U.S. at p. 573.

The Securities Exchange Act, then, does not preclude the California legislation in question. Indeed, as emphasized, federal legislation [15 U.S.C. §78f(c)] requires that all rules adopted by stock exchanges (and therefore, by firms under the authority of such exchanges) conform to appropriate state laws, for "There is nothing built in to the regulatory scheme which performs the antitrust function of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends." *Silver*, 373 U.S. at pp. 358-359.

In light of this language from *Silver*, the California legislation protecting employees' rights to wages and mobility among competing firms does not oppose the purposes and operation of the Securities Exchange Act. The forfeiture provision in the Merrill Lynch profit sharing plan is neither authorized nor protected by any federal law or policy. Nor is it required by New York Stock Exchange rules or regulations. The forfeiture provision is thus not "... necessary to make the Securities Exchange Act work." (*Silver*, 373 U.S. at p. 357).

Accordingly, it cannot be held immune from judicial scrutiny by reason of *Silver* and the rulings by

this Court on identical issues which have arisen in other industries regulated by federal agencies. In cases such as *Carnation Co. v. Pacific Westbound Conf.*, 383 U.S. 213, 218 (1966) and *United States v. Radio Corp. of America*, 358 U.S. 334 (1959), administrative regulation of governmentally created quasi-monopolies did not preempt federal antitrust laws except in those limited instances in which the government deliberately and expressly prohibited some aspect of open competition, thereby immunizing only those specific private practices. See also: *Pan American World Airways, Inc v. United States*, 371 U.S. 296, 305 (1963); *Hughes Tool Co. v. Trans World Airlines, Inc.*, ___ U.S. ___, 93 S.Ct. 647 (1973). No more extensive immunity can or should be articulated by the courts.

"We have long recognized that the antitrust laws represent a fundamental national economic policy and have therefore concluded that we cannot lightly assume that the enactment of a special regulatory scheme for particular aspects of an industry was intended to render more general provisions of the antitrust laws wholly inapplicable to that industry."

Carnation Co. v. Pacific Westbound Conf., 383 U.S. at p. 218.

Pursuant to this principle, antitrust laws have been applied against defendants in the regulated industries even though the conduct forming the basis of the antitrust claim had been approved by an administrative agency:

(a) *United States v. Radio Corp. of America*, 358 U.S. 334 (1959) (F.C.C. approval was a decision

that defendants' conduct would not violate the "public interest, necessity or convenience" and had no bearing on subsequent civil antitrust action).

(b) *California v. F.P.C.*, 369 U.S. 482 (1962) (F.P.C. approval of a merger did not confer antitrust immunity even though the F.P.C. had taken the competitive factor into account prior to passing upon the merger application).

(c) *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963) (Bank merger approved in advance by U. S. Comptroller of Currency pursuant to an Act of Congress was held not to immunize such merger from the antitrust laws—even though the Comptroller duly considered the possible anti-competitive effects of the merger).

(d) *Otter Tail Power Co. v. United States*, 409 U.S. 820, (1973) (The authority and jurisdiction of the F.P.C. to encourage and order interconnections if necessary or appropriate in the public interest does not preclude the maintenance of an antitrust action arising out of the defendant's refusal to make such interconnections. This Court recognized that judicial action did not conflict with the regulatory responsibilities of the F.P.C., even though that federal agency itself has the authority to make decisions on the basis of antitrust considerations).

Cf. *United States v. Trans-Missouri Freight Assn.*, 166 U.S. 290, 314-315, (1897); *United States v. Joint Traffic Ass'n.*, 171 U.S. 505 (1898); *Northern Securities Co. v. United States*, 193 U.S. 197 (1904); *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439 (1945);

Northern Pacific R.R. Co. v. United States, 356 U.S. 1 (1958).

Immunity is created only in those limited instances where Congress has found that open competition—as to certain specified practices—is not in the public interest and, therefore, the legislature commands the parties to pursue a specific course of otherwise anti-competitive conduct (e.g., rate setting, division of markets, etc.)

In a few rare instances, Congress has expressly provided that certain types of advance federal administrative authorization will immunize conduct from anti-trust sanctions. *Hughes Tool Co. v. Trans World Airlines, Inc.*, ___ U.S. ___, 93 S.Ct. 647, 657-658 (1973); *Carnation Co. v. Pacific Westbound Conference*, *supra*; *Pan American World Airways, Inc. v. United States*, *supra*. But this Court noted that under regulatory schemes such as those supervised by the Federal Maritime Commission, the Civil Aeronautics Board and the Interstate Commerce Commission, grants of Congressional immunity were narrow and antitrust laws not completely displaced, 371 U.S. at p. 305.

In *United States v. Radio Corp. of America*, *supra*, after examining the power delegated to the Federal Communications Commission by Congress, the Supreme Court ruled:

“Thus, the legislative history of the Act reveals that the Commission was not given the power to decide antitrust issues, as such, and that Commission action was not intended to prevent enforcement of the antitrust laws in federal courts.” (358 U.S. at p. 346.)

In light of this uniform and consistent line of authority, the present forfeiture clause cannot possibly be immune from antitrust sanctions. It has not even been considered, much less approved, by the Securities and Exchange Commission. A private contractual provision is certainly not more effective in granting antitrust immunity than broad ranges of regulations by official federal agencies.

To hold Article 11.1 immune from judicial scrutiny necessarily means that nearly each and every activity of securities firms would be exempt from antitrust sanctions and judicial intervention. That ruling would not only require overruling *Silver*, but would effectively preclude the application of the Sherman Act as well as all applicable state laws to the regulated industries.

Such broad and undefined immunity is not available, even in the maritime and airline industries, where Congress has granted appropriate federal agencies the power to immunize specific industry conduct. Recently in *Hughes Tool Co. v. Trans World Airlines*, *supra*, this Court found actions of Hughes Tool Company exempt from antitrust sanctions only after determining that the Civil Aeronautics Board had issued orders approving before the fact the very conduct which formed the basis of Trans World Airlines' complaint and that Congress specially immunized such action under 49 U.S.C. §1384.

In response to this unequivocal line of cases rejecting antitrust immunity for the regulated industries, Merrill Lynch can cite only *Flood v. Kuhn*, 407 U.S.

258 (1972) which is clearly distinguishable from our present situation. In *Flood*, this Court held professional baseball's reserve system exempt from antitrust regulation. In so doing, the Court recognized that its decision was an "aberration" (407 U.S. 258 at pp. 282-284) and was, perhaps, illogical since antitrust coverage had been extended to other professional sports. *United States v. International Boxing Club*, 348 U.S. 236 (1955); *Radovich v. National Football League*, 352 U.S. 445 (1957); *Haywood v. National Basketball Association*, 401 U.S. 1204 (1971).

The Court nevertheless felt bound to exempt baseball from federal antitrust laws because of granting such immunity [*Federal Baseball Club v. National League*, 259 U.S. 200 (1922); *Toolson v. New York Yankees, Inc.*, 346 U.S. 356 (1953)] and the "positive inaction" of Congress in refusing to legislatively change this situation even though invited to do so by this Court.

Since its 1953 decision in *Toolson*, *supra*, more than fifty bills have been introduced in Congress concerning baseball's antitrust coverage. 407 U.S. 258 at p. 281. Congressional refusal to modify *Federal Baseball* and *Toolson*, then, was necessarily construed as Congressional approval of the antitrust immunity.

On the other hand, Congress has not—either expressly or implicitly—granted antitrust immunity for private businesses in the securities industry. Congress's "positive inaction" in the ten years since *Silver* was decided, amounts to its acceptance of the application of antitrust sanctions in the securities indus-

try, and the need for judicial safeguards. This Court's decision in *Silver* applying antitrust laws within the securities industry has received Congressional approval by the Senate subcommittee which recently concluded a lengthy examination of industry practices.

During these hearings, the Securities and Exchange Commission took the position that it should have jurisdiction to decide whether an exchange rule was necessary to make the Exchange Act work. The Securities and Exchange Commission asserted "that this power is necessary to prevent judicial interference that would upset the regulatory scheme of the Exchange Act." The Senate Subcommittee concluded that to vest such authority in the Securities and Exchange Commission would be antithetical to "the decided cases involving the securities industries and other related industries." B.N.A. *Securities Regulation & Law Report* No. 190, E-6, February 21, 1973.

The present action cannot, therefore, be held precluded by federal regulation in the securities field. Neither the Merrill Lynch forfeiture provision nor the New York Stock Exchange compulsory arbitration rule (as applied to employer-employee wage disputes) has been shown to be necessary (or, for that matter, even desirable) to federal securities policies.

In *Ware* as in *Silver*, *supra*, and *Thill*, *supra*, there is no evidence that the rules and practices challenged by respondents concern matters over which the Securities and Exchange Commission could exercise adequate review. *Thill Securities Corp. v. New York Stock Exchange*, 433 F.2d 264 (7th Cir. 1970).

In *Ricci v. Chicago Mercantile Exchange*, ___ U.S. ___, 93 S.Ct. 573 (1973), the limitations placed upon the Securities and Exchange Commission by Congress "to review specific instances of enforcement of Exchange rules" were confirmed. At p. 580, Ricci, a member of the Chicago Mercantile Exchange, was allegedly deprived of membership by said Exchange contrary to the Commodities Exchange Act, 7 U.S.C. 1 §1, et seq. and the rules of the Exchange. He alleged a conspiracy in violation of the Sherman Act. This Court stayed the judicial proceedings and referred the matter to the Commodities Exchange Commission to determine "whether the transfer of Ricci's membership was in violation of the Act for failure to follow Exchange rules." The Securities and Exchange Commission has no such similar authority.

The Court, however, explicitly stated that no prior agency ruling would foreclose the courts from deciding the antitrust question. The Commission would act only in an advisory capacity. Moreover, the Court found that Congress did not intend "the Act to confer general antitrust immunity on the Exchange and its members with respect to that area of conduct within the adjudicative or rule making authority of the Commission or the Secretary." *Id.* at p. 581 n. 13.

In his dissenting opinion, Justice Marshall, felt that the invocation of the doctrine of primary jurisdiction would derogate "from the principle that except in extraordinary situations, every citizen is entitled to call upon the judiciary for expeditious vindication of his legal claims of right." 93 S.Ct. at p. 589.

Contrary to the holding in *Ricci*, Merrill Lynch asks this Court to allow, not an independent federal agency or a Court, but rather, an arbitration board empaneled by the New York Stock Exchange to conclusively decide whether one of its own rules serves a valid self-regulatory purpose and, further, whether its most powerful and influential member firm pursues an anti-competitive and illegal policy in dealing with its employees through its profit sharing plan.

"The Securities Exchange Act of 1934 delegates to industry self-regulatory bodies quasi-governmental powers over their members. In so doing, the statute sanctions the concept of a group of competitors agreeing to impose restrictions upon themselves, including restrictions upon how they will compete with one another and restrictions affecting competitors who are not members of the group. This in turn creates the possibility that the group will use its power, intentionally or unintentionally, to limit competition or disadvantage non-member competitors in a way which does not further the purposes of the 1934 Act.

To protect the public and competitors against unjustified anti-competitive restrictions, the rules and actions of the self-regulatory organizations must be subject to review under antitrust standards." Senate Securities Sub-Committee Report, B.N.A., *Securities Regulation and Law Report* No. 190, E-6, February 21, 1973.

Finally, Merrill Lynch's demand for compulsory arbitration in this dispute ignores the rule that state and federal antitrust claims are not arbitrable. *Aksen, Arbitration and Antitrust—Are They Compatible?* 44 N.Y.U.L. Rev. 1097 (1969).

When confronted with the choice of arbitration in matters of strong public policy, the courts have unanimously held "... the broadest of arbitration agreements cannot oust our courts from their roles in the enforcement of major state policies, especially those embodied in statutory form..." *Matter of Aimcee Wholesale Corp.*, 21 N.Y.2d 621, 629, 237 N.E.2d 223 (1968). Federal law is in accord. *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2nd Cir. 1968); *Power Replacements, Inc. v. Air Preheater Co.*, 426 F.2d 980 (9th Cir. 1970); *A. & E. Plastik Pak Co. v. Monsanto Co.*, 396 F.2d 710 (9th Cir. 1968).

"Trial by jury, not by arbitrators, expert in other things, is 'an essential part of the Congressional plan for making competition rather than monopoly the rule of trade * * *.'" *Silvercup Bakers, Inc. v. Fink Baking Corp.*, 273 F.Supp. 159 (S.D. N.Y. 1967); *Associated Milk Dealers v. Milk Drivers Union Local 753*, 422 F.2d 546 (7th Cir. 1970).

This rule has cogent application in the instant dispute. It is a question of law rather than fact whether a forfeiture provision contained in a profit sharing plan violates state or federal antitrust laws. Merrill Lynch cannot be allowed to hide its unlawful conduct behind the veil of an industry-dominated arbitration system.

III

THE CALIFORNIA LEGISLATION HEREIN CHALLENGED DOES NOT CONSTITUTE AN UNDUE BURDEN ON INTERSTATE COMMERCE.

Merrill Lynch urges that by reason of the interstate aspects of its profit sharing plan, any disparity of treatment given such plan constitutes an impermissible burden on interstate commerce.¹³

No uniform application is required by either state or federal law. Professor Harlan M. Blake, in his extensive analysis of post-employment anti-competitive agreements, observed: "The moral for a draftsman is that generally when a multi-state restraint is required, it should satisfy the requirements of reasonableness of the most exacting state within the terms of the restraint." *Blake, Employee Agreements Not To Compete*, 73 Harv.L.Rev. 625, 688, n. 211 (1960).

Merrill Lynch contends that there is an important interest in national uniformity in regulating businesses in the securities industry, but California has not attempted by the decision in *Ware* to control any aspect of petitioner's securities business.

What national interest demands national uniformity in employer-employee relations in the securities industry? Who is to set these national standards?

¹³Petitioner did not advise this Court that by letter dated October 22, 1972, Merrill Lynch discontinued the operation of its profit sharing plan and agreed to pay to all employees terminated after that date one hundred percent (100%) of the monies credited to their respective accounts, whether or not they resigned and secured competitive employment. California employees who have left Merrill Lynch since October, 1972, have likewise received their profit sharing interests regardless of entering competitive activity.

(Neither Congress nor the Securities and Exchange Commission has established standards.) Are these to be set by the employer-dominated New York Stock Exchange? Or by each internationally-organized brokerage house? Is a sovereign state helpless and impotent in its attempt to protect employees in their dealings with economically superior employers?

Numerous leading decisions by this Court, such as *Brotherhood of Locomotive Firemen & Enginemen v. Chicago, Rock Island & Pacific Railroad Co.*, 393 U.S. 129 (1968); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440 (1960); and *Parker v. Brown*, *supra*, are instructive by analogy in proving that the California statutes in issue do not constitute an undue burden on interstate commerce.

In the *Brotherhood of Firemen* case, a group of interstate railroads attacked an Arkansas statute requiring full crews (including at least one fireman) on each train. Like Merrill Lynch here, the railroads argued that they were organized on an interstate basis, where the need for uniformity in the interstate transportation industry was essential. Notwithstanding, this Court upheld the Arkansas full crew law on the ground that it promoted a valid state interest in safety, (393 U.S. at p. 140). The evidence concerning the safety value of firemen was—at best—mixed and Congress had referred the entire full crew dispute to an arbitration board. (393 U.S. at p. 134).

The same conclusion follows from the *Huron Cement Co.* case, *supra*. Even though Congress had established standards, required inspections and au-

thorized certificates as to Huron's steamships and other vessels in interstate commerce, a local ordinance enacted for the purpose of minimizing air pollution, and imposing more stringent specifications, was upheld by this court. (362 U.S. at p. 448). Merrill Lynch has not demonstrated that the forfeiture provision is *required* by the laws of any other state in which it transacts business, or by federal law.

Likewise, in *Parker v. Brown, supra*, state action which seemed to clearly burden interstate commerce by imposing anti-competitive marketing restrictions on the interstate sale of raisins was held valid, as being consistent with federal policies dealing with other aspects of the agricultural industry. (316 U.S. at pp. 352-358).

Merrill Lynch's reliance on *Flood v. Kuhn*, 407 U.S. 258 (1972) as support for its argument that state antitrust legislation burdens interstate commerce in the securities industry is mistaken. This Court's refusal to apply state antitrust laws to baseball in *Flood* was based on a finding that Congress by its "positive inaction" had demonstrated its intent that baseball's reserve system was to be immune from all antitrust laws. Congressional intent controls the application of antitrust regulation.

In our present case, Congress has mandated that stock exchanges and their member firms operate within state regulation. Moreover, the California laws in issue are consistent with federal policies banning anti-competitive restraints; complement and reinforce federal antitrust policy in its application to practices

within the securities industry; and do not constitute undue burdens on interstate commerce.

The mere fact that a business is engaged in interstate commerce and that the state law imposes some restraint on that business or its commerce "... does not add up to an unconstitutional burden on interstate commerce." *Head v. New Mexico Board of Examiners in Optometry*, 374 U.S. 424, 428 (1963). In *Head*, the Court found it important that "... appellants ... pointed to no regulations of other states imposing conflicting duties, nor can we readily imagine any." 374 U.S. at p. 429 citing *Colorado Anti-Discrimination Comm'n. v. Continental Air Lines*, 372 U.S. 714 (1963).

One who challenges the constitutionality of state statutes bears the onus of proving that an unreasonable burden on commerce has been created. That responsibility has not been discharged in the present case. It has not been shown that the California legislation exceeds the limits necessary to vindicate an important state interest; or that it unreasonably favors local businesses at the expense of out-of-state competitors; or that it attempts to regulate and control conduct beyond state borders. *Florida Lime & Avocado Growers, Inc. v. Paul*, *supra*, 373 U.S. at p. 154.

In *Collins v. American Buslines*, 350 U.S. 528 (1956), respondent, an interstate carrier, asserted that to compel it to comply with different state Workmen's Compensation Insurance requirements created an impermissible burden on interstate com-

merce. Merrill Lynch's contention can be dispatched in the same manner as was the argument in *Collins*.

"Whatever dollars-and-cents burden an eventual judgment for the claimants in the position of petitioners may cast . . . is insufficient, compared with the interest of the State in affording remedies for injuries committed within its boundaries . . . to dislodge state power . . ." 350 U.S. at p. 531.¹⁴

The underlying state interest in prohibiting restraints of trade, the common law forerunner of the Sherman Act is significant. "The public's stake in wide disseminations of such decisions is too great to allow them to be submerged in the anonymity of the arbitration process." *Pitofsky, Arbitration and Antitrust Enforcement*, 44 N.Y.U.L. Rev. 1072, 1077 (1969).

The philosophy underlying §16600 can be summarized as follows:

... post employment restraints reduce both the economic mobility of employees and their

¹⁴*Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959) is inapposite. In *Bibb*, trucks equipped with mud guards as required by Illinois law were prohibited from the roads of another state. In *Bibb*, as in *Southern Pacific Co. v. Arizona*, 325 U.S. 761 (1945), the state's regulations of transportation industries could not be justified since the evidence demonstrated that the statutory requirements created greater safety hazards. Thus, the free flow of commerce was impeded and no state interest was promoted. Moreover, as this Court made clear in its ruling in *Florida Lime & Avocado Growers, Inc. v. Paul*, *supra*, the state laws in *Bibb* and *Southern Pacific* were struck down because they sought to control the conduct of the regulated parties beyond the borders of the regulating states. 378 U.S. at p. 154.

None of these considerations apply to the California legislation involved in the present case.

personal freedom to follow their own interests. These restraints also diminish competition by intimidating potential competitors and by slowing down the dissemination of ideas, processes, and methods. They unfairly weaken the individual employee's bargaining position vis-a-vis his employer and, from the social point of view, clog the market's channeling of manpower to employments in which its productivity is greatest." *Blake, Employee Agreements Not To Compete*, 73 Harv.L.Rev. 625, 627 (1960).

The author was of the opinion that given the required effect on commerce, such restraints would be violative of the Sherman Act. (At p. 628).

This Court has condemned similar arbitration agreements which in and of themselves were used as vehicles to protect violators from antitrust actions. *Paramount Famous Lasky Corp. v. U.S.*, 282 U.S. 30 (1930); *Fox Film Corp. v. Muller*, 296 U.S. 207 (1935). The same situation concerns the Court today. Merrill Lynch and the New York Stock Exchange operate within an admitted anti-competitive environment. In an effort to insulate their dealings from judicial scrutiny, the Exchange and its "club members" have established blanket arbitration rules which in no manner further the purposes of the Securities Exchange Act. "Such unjustified self-regulatory activity can only diminish public respect for and confidence in the integrity and efficacy of the exchange mechanism." *Silver v. New York Stock Exchange*, 373 U.S. 341, 359 (1963).

In the final analysis, burdens on interstate commerce must be measured by the extent to which state legislation conforms or conflicts with Congressional intent (express or implied) concerning regulation of the field involved. *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408 (1946). Here both this Court and Congress have overwhelmingly signified approval of the type of state action reflected in the California legislation under consideration.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the order and decision of the Court below should be affirmed.

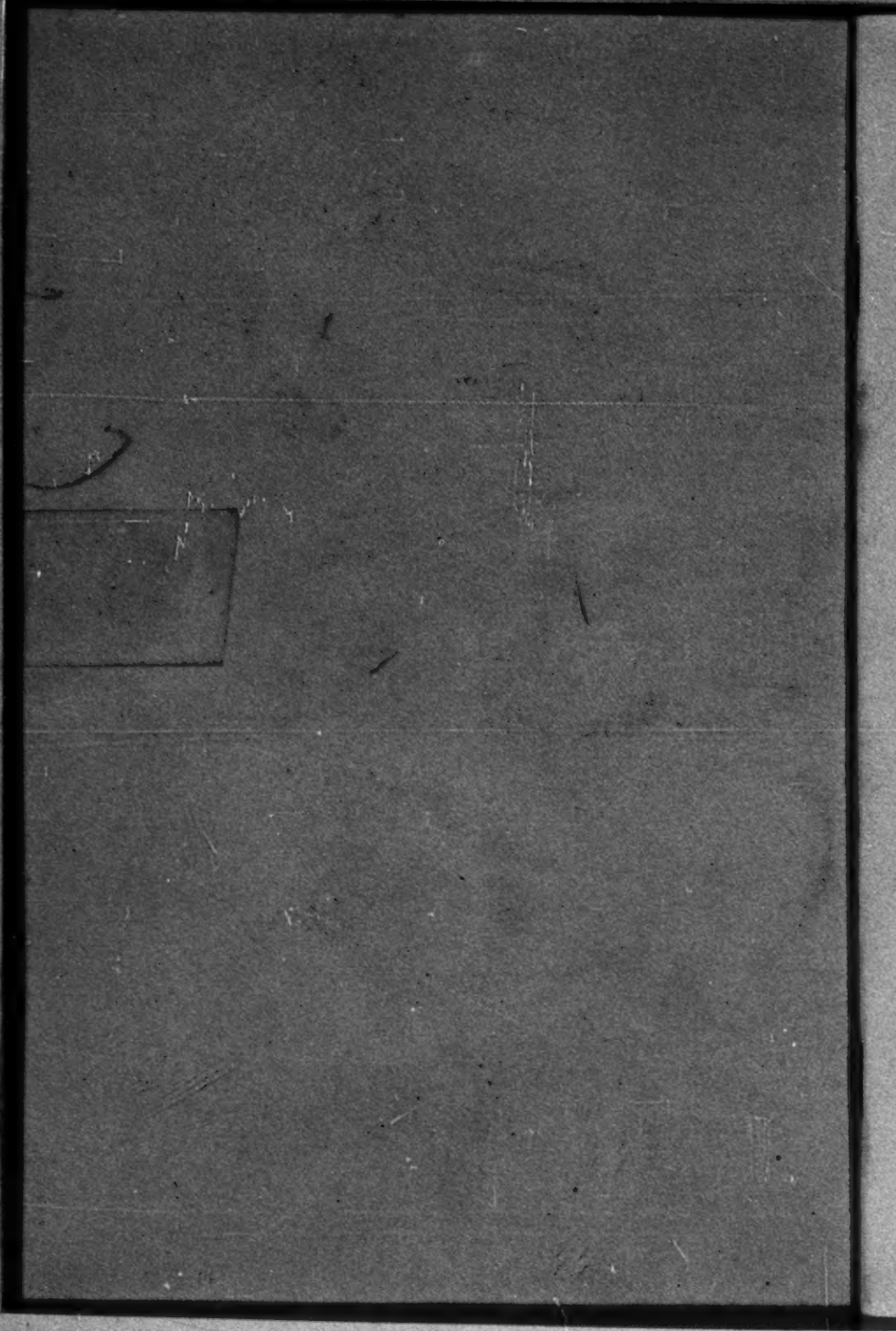
Dated, San Francisco, California,

May 17, 1973.

JOSEPH C. BARTON,

THOMAS E. FEENEY,

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OCT 5 1973

MICHAEL ROSAK, JR., CL

In the Supreme Court of the
United States

OCTOBER TERM, 1972

No. 72-312

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

VS.

DAVID WARE, *et al.*,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State
of California for the First Appellate District

Reply Brief for Petitioner

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October 4, 1973



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In the Supreme Court of the United States

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No. 72-312

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vs.

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Respondents.

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of California for the First Appellate District

Reply Brief for Petitioner

INTRODUCTION

At the heart of this case lies the central fact that the securities industry is the only industry in this country which is subjected to federally mandated self-regulation. The statutory scheme calls for the registration of stock exchanges and the filing and review of their constitutions, by-laws, and rules by the Securities and Exchange Commission. There is nothing more fundamental to this scheme of self-regulation than the regulation of the individuals who deal with the public on behalf of the member firms.

The New York Stock Exchange has fully recognized this and has established rigid standards with respect to personal integrity and a knowledge of the securities industry which must be met by registered representatives. Among other things, it requires registered representatives to agree to arbitrate any dispute they may have with their employer, a member firm, and the Exchange (with the implicit approval of the Commission) has made this a condition of their obtaining a "license" to do business as a registered representative.

The 1934 Act was designed to protect the investor and restore public confidence in the industry. Clearly, it was and is in the public interest not only to have registered representatives of the highest integrity, but also to eliminate controversy between registered representatives and the member firms by whom they are employed, which would be heightened by the normal and undue publicity accompanying the trial of lawsuits.

This case is not a case involving the wage rights of seamen, who were wards of the court, or bricklayers, or ditch diggers. It is, on the contrary, a case involving the regulation of a highly specialized profession, requiring of those who practice it, the highest standards. To maintain the standards, a pervasive system of self regulation has been adopted by the New York Stock Exchange. It is a case raising issues determinative of the powers of the self regulation of the industry. Should one state, California, for example, be able by statute to totally undercut the sound rules of self regulation promulgated by the Exchange under the authority of the 1934 Act? Should one state, California for example, be able to void an agreement (valid under Federal law and in most other states) simply by the application of a labor law or a so-called antitrust law ruled inapplicable elsewhere? Petitioner submits the answers are no.

What must be decided here is how to balance, if ever so delicately, the strong and clear federal policies of self regulation of the securities industry and preference for arbitration against the right of the states to undercut the rules providing for self-regulation and the national and state policy favoring arbitration. We shall deal seriatim with Respondents' attempt to convert a case involving these important national considerations into a local labor matter or a due process case.

I

LABOR CODE SECTION 229 IS NOT CONSONANT WITH FEDERAL LAW AND POLICY

The central legal issue in this case is whether, given a Congressionally mandated obligation on exchanges to adopt rules and regulations as part of a self-regulatory scheme, and a strong federal statutory and judicial policy in favor of arbitration, Rule 347(b) of the New York Stock Exchange, reflecting a synthesis of these policies, must be subservient to California Labor Code § 229, which the court below deemed to be an exception to a similar state policy favoring arbitration. (App. 66).

This Court, in considering the validity of state laws in light of federal laws touching the same subject, has confirmed that "no one crystal clear distinctly-marked formula" applies. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). However, where the state policy or statute produces a result inconsistent with the objectives of the federal statute,¹ evidence of preemption or supersession is usually found, e.g., *Rice v. Santa Fe Elevator Co.*, 331 U.S. 218 (1947).

1. The federal "statute" may, of course, be a regulatory or administrative rule or order, e.g., *Free v. Bland*, 369 U.S. 663 (1962).

California Labor Code § 229 produces just such an inconsistent result here. It does so because, when the competing policies, state and federal, are balanced, it becomes clear that the combined federal policies referred to above can only be fully effectuated by disregarding California Labor Code § 229.

The conflict produced here essentially involves a choice of forum for resolution of a dispute, and is the type of conflict which this Court has faced before. The resolution of that conflict, to paraphrase the late Mr. Justice Harlan, involves forging a proper relationship between available arbitral and judicial forums. *United States Bulk Carriers, Inc. v. Arguelles*, 400 U.S. 351, 359 (1971) (concurring opinion). In creating a proper relationship close attention has been focused on the policies underlying arbitration and those on which the availability of alternative forums are founded. 400 U.S. at 359.

From their analysis of these competing policies, respondents argue that California Labor Code § 229 is entirely inharmonious with federal law and policy. That analysis, however, presents not only a misleading picture of the posture of respondents in the industry structure, but also overlooks other important considerations which tip the balancing scales in favor of arbitration. Rule 347(b) is necessary to effectuate the purposes of the 1934 Act because it fulfills both the Congressional intent to involve the exchanges in the self-regulatory scheme and also the federal policy in favor of arbitration set forth in the United States Arbitration Act and in other federal laws recognizing it as the key element of any scheme of industrial self-regulation. These combined federal policies are thwarted from full operation by the Court of Appeal decision.

Congress expressly granted rule-making authority to registered stock exchanges in the 1934 Act. 15 U.S.C. § 78f.

Rule 347(b) was promulgated by the Exchange in fulfillment of that objective. As Mr. Justice Goldberg observed in *Silver*:

"It is no accident that the Exchange's Constitution and rules are permeated with instances of regulation of members' relationships with nonmembers . . ." *Silver v. New York Stock Exchange*, 373 U.S. 341, 354 (1963).

The arbitration rule was deliberately designed to carry out the Exchange's duty under § 6, 373 U.S. 341, 353-54 & n. 9.

Aside from the clear statutory language and the historical context in which the 1934 Act was adopted,² there are other indicia of Congressional intent.

Under § 6(c) Congress expressly authorized an exchange to adopt rules not inconsistent with the Act and the "applicable laws of the State in which it is located." 15 U.S.C. § 78f(c). Respondents urge that the New York Stock Exchange is located in California, both as an entity itself and through its members and, therefore, is subject to California law under § 6(c). That a corporation or association is located where its stockholders or members reside is a concept long since discredited, *e.g.*, 28 U.S.C. § 1332(e). Nor is the Exchange "located" in California. Although Congress did not define "located" in the 1934 Act, it has used the term in other statutes in which the term has uniformly been interpreted to mean the state of incorporation or the state where the corporation's principal place of business is conducted. *E.g.*, *Texaco, Inc. v. Federal Power Comm'n*, 377 U.S. 33 (1964) (Natural Gas Act, 15 U.S.C. § 717r(b)); *United States National Bank v. Hill*, 433 F.2d 1019 (9th Cir. 1970) (National Banking Act, 12 U.S.C. § 94). Applying

2. *See, e.g.*, Report of the Subcommittee on Securities, U.S. Senate Committee on Banking, Housing and Urban Affairs, 93rd Cong., 1st Sess. 137-144 (1973) (hereinafter cited as "Securities Industry Study").

these standards, New York is clearly the state where the Exchange is located. Congress undoubtedly sought to create uniformity of application by referring to the laws of one state. That uniformity is defeated by the application of California law, since New York has no statute comparable to California Labor Code § 229.

The self-regulatory system has also received renewed approval by both the SEC and the Congress. Some thirty years after the 1934 Act had been adopted the Commission made a special study of the American Stock Exchange, in which it concluded:

"Regulation in the field of securities should continue to be based on the principle of giving maximum scope to self-regulation, wherever and to the extent that a regulatory need can be satisfactorily met through self-regulation." 4 SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. 726 (1963).

The Commission obviously felt that the statutory concept of substantial reliance on industry self-regulation had stood the test of time. There is nothing in the record to support respondents' claims that the self-regulatory need—control over the employment relationship—cannot satisfactorily be met by self-regulation of the type embodied in Rule 347(b).

Of course, Congress did not intend the self-regulation be completely unsupervised. But, as petitioner has previously argued, § 19(b) gives the SEC power to review and disapprove Rule 347(b) or any other Exchange rule, as this Court recognized in *Silver*. 373 U.S. at 357.³

3. In its motion for reconsideration of an order staying the effectiveness of new institutional membership rules, the Commission referred to section 19(b) of the 1934 Act as the embodiment of the philosophy of supervised self-regulation. *PBW Stock Exchange, Inc. v. SEC*, CCH Fed. Sec. Law Rep. ¶ 94,005 (3d Cir., May 1973).

Thus, §§ 6(a), 6(c) and 19(b) articulate both the ability and duty to review rules and regulations to insure that exchange rules are appropriate and in the public interest.

The most recent Congressional evaluation of the structure of the regulatory system, while criticising certain weaknesses, has reaffirmed both the concept and the results:

"The securities industry's unique system of self-regulation has shown great strength in some areas and in general has served the industry well." Securities Industry Study at 137.

Rule 347(b) is a particularly appropriate exercise of this self-regulatory function, since it incorporates arbitration into the regulatory scheme. Arbitration, enjoying the support of the federal policy expressed in the U.S. Arbitration Act, has long been recognized by this Court to be a key element of any scheme of industrial self-regulation. Relevant decisions in this court have expressed a national labor policy favoring the settlement of disputes by means of arbitration in lieu of litigation. This Court's opinions, based on § 301 of the Labor-Management Relations Act of 1947, have been predicated on the theory that arbitration is a substitute for industrial disruption. The arbitration procedure lies in the very heart of the policy of industrial self-government. This policy is not dissimilar to the supervised self-regulation which Congress has mandated in the securities field. Just as in the labor field, arbitration performs functions which bring experience and expertise to a special area.

The question of the enforcement of the non-competition clauses of the Merrill Lynch Profit Sharing Plan depend in large part on the facts and nature of the industry, which is better equipped to handle these problems. The evaluation of the clause depends on the circumstances involved,

the nature of the industry needs, and the effect on the investing public.

The disposition of the issue of arbitrability presented here caused the Court of Appeal to examine and interpret a provision in the agreement in light of a legal principle without consideration of the context in which the clause was adopted. Thus in reality it purported to decide the merits of the dispute under the guise of determining arbitrability.

The arbitration policy is also embodied in federal law. United States Arbitration Act, 9 U.S.C. § 1 *et seq.* Petitioner has previously argued that the United States Arbitration Act, and the substantive law established thereunder, must be considered in this case, particularly in order to preclude forum shopping that may and does have conflicting results.

In *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956) this Court held that the Act applied only to the kinds of contracts specified in sections 1 and 2, namely, admiralty contracts or transactions in commerce. The contract here, namely the RE-1 Form, is a transaction involving commerce because respondents' services as account executives called for dealing with the public wherever located and to use the facilities of interstate commerce in conducting Merrill Lynch's business on an interstate basis. *Accord*, *Dickstein v. duPont*, 320 F.Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971). It is, in all practical respects, identical to the consulting agreement which this Court found to be a transaction in commerce under the Act in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).⁴

4. Section 1 of the Act exempts from its operation "contracts of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce. 9 U.S.C. § 1. The exclusion has been uniformly interpreted to refer only to workers engaged in the movement of commerce or so closely related

Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F. 2d 402 (2d Cir. 1959), cert. dismissed, 364 U.S. 801 (1960), established that the validity, revocability and applicability of arbitration agreements affecting commerce are to be determined under federal law, a result approved in *Prima Paint*.

The substantive law established in the United States Arbitration Act in *Robert Lawrence*, and as applied in *Prima Paint* and *Dickstein*, is contrary to the result reached by the Court of Appeal below. There is no question that Merrill Lynch could have sought arbitration below under the United States Arbitration Act. The result created by the divergent approaches of the *Dickstein* court and the court below, is apparent. If permitted to stand, it will place a premium on the forum in which the party desiring to litigate chooses to bring his action. It further places the party desiring to arbitrate in a position that is fundamentally unfair to him. Labor Code § 229 precludes the uniformity that is not only desirable, but required under the federal substantive law embodied in the Act.

Sections 3, 4 and 5 of the Act have been classified as procedural devices for the implementation of § 2. Section 4, which provides the power to compel arbitration, 9 U.S.C. § 4, is identical with its California counterpart under which petitioner sought arbitration. California Code of Civil Procedure, § 1281.2. The right is of little value if litigation can be concurrently maintained. When state law prevents the operation of these sections, the federal right to arbitration is threatened and state law should not control.

to it to be part of it in practical effect. Respondents here are not "workers" within the meaning of the exclusion from § 1 of the Act. *E.g., Bernhardt v. Polygraphic Co.*, 218 F.2d 948, 951-52 (2d Cir. 1955), rev'd on other grounds, 350 U.S. 198 (1956); *Dickstein v. duPont*, 320 F.Supp. 150, 152 (D. Mass. 1970), aff'd, 443 F.2d 783, 785 (1st Cir. 1971) (registered representative not worker engaged in commerce).

Different results due to the fortuity of the forum have already occurred. The Minnesota Supreme Court has upheld the Exchange arbitration rules under Minnesota's arbitration statute in an action by a registered representative challenging a non-competition clause in a member firm's pension plan. *Movils v. Francis I. duPont & Co.*, 189 N.W.2d 487 (Minn. 1971). In addition to the *Dickstein* case, an even more striking example of the conflict comes from the Seventh Circuit. There, a former Merrill Lynch employee brought a class action challenging the invalidity of the same non-competition clause involved here on the ground that it violated the Sherman Act. The Seventh Circuit upheld a district court order compelling arbitration under the United States Arbitration Act. *Cullinan v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, No. 72-2046, (7th Cir., April 27, 1973).⁵

The reasons why it is necessary to apply federal law are cogently set forth in a recent decision of the New York Court of Appeal:

"It is particularly important to apply Federal Law in the present case for, to hold otherwise would (1) permit, indeed encourage, forum shopping; (2) prevent and undermine the need for nationwide uniformity in the interpretation and application of arbitration clauses in foreign and interstate transactions; and (3) permit individuals to circumvent the national law relating to arbitration agreements as called for by the F.A.A. [Federal Arbitration Act]." *A/S J. Ludwig Mowinckels Rederi v. Dow Chemical Co.*, 307 N.Y.S.2d 576 (N.Y.Ct.App.), *cert. denied*, 398 U.S. 939 (1970).

5. A copy of this unreported opinion is attached to this brief as Appendix A. Counsel for Petitioner requested permission of the Seventh Circuit to reprint the opinion and was referred to Seventh Circuit Rule 28(4) which prohibits citation to an unreported opinion "within the circuit." Counsel has interpreted this rule to permit citation to this Court.

In that case the appellant sought to prevent arbitration under a New York law which barred arbitration if it were time-barred. No limitation is contained in the federal Act. Chief Judge Fuld recognized that a state law precluding arbitration on a ground not recognized by federal law "denied the full measure of enforceability provided for by the" federal Act, 307 N.Y.S.2d at 663. In so doing he gave full recognition to both *Robert Lawrence* and *Prima Paint*, as the Court of Appeal below should have done here. In reaching its result the Court of Appeal totally ignored these federal policies and deprived petitioner of its rights under these policies and federal law, contrary to Congressional intent.

From the purposes and intent of the synthesis of these federal policies, it becomes apparent that Rule 347(b) carries out these objectives. One of the principal duties of the Exchange under the Congressional mandate is to protect the investing public and insure just and equitable trade practices. Exercising the rule-making function over the employment relationship promotes that objective, since it is those very employees who assist the investing public in securities transactions and who represent their member firms to the investing public. In no other industry is confidence in the integrity and abilities of those involved in its administration so fundamental to its operation. As witnessed in recent years, it is no overstatement that member firms have experienced severe financial problems, including failures resulting in substantial losses to the investing public. Although Congress has recently enacted laws pertaining to this particular problem, Securities Investor Protection Act, 15 U.S.C. §§ 78o(c)(3), 78 aaa *et seq.*, and is presently considering other legislation, *e.g.*, Securities Industry Study, *supra* note 2, the loss of confidence in the industry in the past five years is apparent. Protracted liti-

gation between member firms and their employees over all kinds of claims, including those relating to compensation, further erode the public loss of confidence. Without arbitration there is no prompt and fair method of resolving those disputes. In the context of the industry's responsibilities, Rule 347(b) is clearly necessary to the fulfillment of that objective and particularly to sustain public confidence in the industry itself, a basic objective of the 1934 Act.

Rule 347(b) covers disputes relating to both present and former employees. Exchange authority over that relationship must be pervasive, extending both to present employees and those who have left the industry, as part of the Exchange's continuing supervisory role.

To apply state law per se without utilizing the arbitral forum strikes at the heart of that process. Abstention by the judiciary in order to allow the dispute to be resolved as agreed upon does not divest the court of jurisdiction. But it does promote the federal intent evidenced by the rule-making grant, the Exchange's promulgation of the rule in fulfillment of that intent, the Commission's implicit approval of the rule when it was first filed as part of the registration process, and federal arbitration law and policy.

II.

BUSINESS AND PROFESSIONS CODE SECTION 16600 DOES NOT AND SHOULD NOT PREVENT ARBITRATION

Respondents claim that Business and Professions Code § 16600 stands as an independent basis for denying arbitration. Aside from the fact that it rests on the same footing as Labor Code § 229, there are even more cogent reasons why respondents' argument should not prevail.

In the first place, the section does not even mean what it says, since there are judicially created exceptions to it,

e.g., *Gordon v. Landau*, 49 Cal.2d 690, 321 P.2d 456 (1958). For example, as the court recognized, *Frame v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, Article 11:1 is valid insofar as it applies to subjects of restraint such as breaches of confidence, trade secrets, and misappropriation of customer lists. (App. 74). The *Frame* court was not directly overruled by *Ware*. *Frame* undoubtedly had in mind not only California Labor Code § 2860⁶ but the appropriateness of these issues for arbitration. Such issues, including the enforcement or non-enforcement of the non-competition clause, should be resolved by those experienced in the industry, as they are better equipped to review those needs within the self-regulatory context.

Secondly, arbitration under Exchange rules permits uniformity of interpretation of these clauses by those experienced in the industry. Such uniformity is lost if state laws are applied at the outset to determine the merits of an issue which should be arbitrated. It is inconsistent to permit one employee to retain the benefits of an employment relationship evidencing interstate commerce centered in one jurisdiction, New York, but to deny the employer the right to enforce restrictive covenants valid in that jurisdiction but invalid in other jurisdictions where the employee may conduct the employer's business. To do so places the employee in the latter jurisdiction in a more favorable position than an employee in the former jurisdiction, and serves to diminish the purposes of the employer in protecting his investment in the ability and integrity of the employee, an investment which serves the very purpose of the 1934 Act—to protect the investing public.

6. "Everything an employee acquires by virtue of his employment . . . belongs to the employer whether acquired . . . during or after the expiration of the term of his employment."

The integrity and training of the registered representative serve the interests of the public investor. The "legislative" powers granted to the Exchange and its members is to be used for the public investor's interests. This sanctioned concept, by its very terms, approves the concept of a group of competitors agreeing to impose restrictions upon themselves, including restrictions relating to competition.⁷

Thirdly, the application of substantive federal arbitration law to achieve the uniformity previously discussed, would, in the federal context, not be denied as a result of federal antitrust statutes. Not only does such a clause not violate those statutes, but under *Prima Paint*, if the issue of fraud in the inducement of the arbitration agreement itself is for an arbitrator to resolve, so should an alleged state antitrust claim.

Fourthly, the Exchange arbitration rules have been upheld in the face of federal antitrust challenges. A state statute is not entitled to treatment in any different manner. To do so not only frustrates the arbitration rule as a self-regulatory rule, but also leads to different results depending upon the application of state law, thus burdening the uniform operation of Merrill Lynch's Profit Sharing Plan.⁸

Lastly, the effect of Business and Professions Code § 16600 is to deprive participants of the Merrill Lynch

7. Respondent suggests that if other member firms have similar restrictions, such concerted action amounts to a federal antitrust violation. No such violation was pleaded and the record contains nothing to suggest any concerted action.

8. Respondent is correct that, as of September 13, 1972, Merrill Lynch terminated its Profit Sharing Plan, fully vested all active employees on that date, and eliminated the non-competition clause. All benefits, except for a contingency fund, were distributed to employees who were participants on the effective date of plan termination. But that does not change the posture of this case or petitioner's arguments on uniformity, since it is faced with a number of lawsuits identical to this one in other jurisdictions, and it continues to use a non-competition clause in its pension plan.

Profit Sharing Plan who remained with Merrill Lynch of their right to receive their respective portions of any of respondents' forfeitures under Article 5. As applied here, § 16600 is both arbitrary and unequal in its operation, since it completely disregards the rights of all participants other than respondents.

III.

RESPONDENTS' ARGUMENTS THAT ARBITRATION WILL DEPRIVE THEM OF A RIGHT TO A JUDICIAL FORUM AND WILL BE FUNDAMENTALLY UNFAIR ARE NOT SUPPORTED BY LAW OR FACT

Throughout their brief respondents assert a simple theme, namely, that arbitration in this case will deprive them of the right to a judicial forum and will be fundamentally unfair. Neither of these arguments find any support in the record or in relevant and sound legal principles.

A. The Rights and Remedies Provided in the Securities Laws Are Not Applicable to this Dispute.

Relying principally on §§ 6(a)(1), 28(a)(b) and 29(a) of the 1934 Act, 15 U.S.C. §§ 78f(a)(1), 78bb(a)(b), and 78cc(a), respectively, respondents equate the forum conflict here with that conflict present in *Wilko v. Swan*, 346 U.S. 427 (1953). In so structuring the issue they seek to place themselves and their dispute on a level identical to that of the public investor. As Merrill Lynch has previously noted respondents are not investors. They are the subjects, not the objects of the 1934 Act. Moreover, their suit does not involve violations of securities laws. The conflict in *Wilko* was between the policy underlying the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.*, and Congressional policy to provide *security purchasers* with a judicial forum under § 12(2) of the securities Act of 1933, 15 U.S.C. § 77f(2), coupled with a policy prohibiting waiver of these rights in

§ 14, 15 U.S.C. § 77n.⁹ The policy factors which led this Court in *Wilko* to a balance giving the rights secured by the securities laws predominance over the federal policy of arbitration are inapposite. Here the federal policies expressed in the securities laws work in concert with the federal policy of arbitration.

Nor, as respondents urge, is every case which has considered the arbitration rules wrongly decided under *Wilko*. Each of those courts¹⁰ recognized and continue to recognize,¹¹ this fundamental difference between the situation in *Wilko* and the situation present in those cases, and here.

Indeed, each of those courts carefully considered the choice of forum issue in light of the non-waiver provisions of § 29(a) and unanimously concluded that § 28(b) exempts arbitration from § 29(a). Any other conclusion would render the Exchange arbitration rules meaningless, a result Congress cannot have presumed to have intended, and certainly not with respect to a state law.

Respondents look to Article VIII of the Exchange Constitution to argue that petitioner cannot compel them, as non-members, to arbitrate because that article provides in part that any controversy between a member and non-member shall be submitted to arbitration at the instance of the non-member. This overlooks the fact that the non-member's request for arbitration as set forth in the RE-1 Form is the request itself under Article VIII. See *e.g.*, 2R, Appendices D, E. Moreover, the source of authority for Rule 347(b) is independent of Article VIII. As far as Exchange

9. Respondents claim that the change in language between section 14 of the 1933 Act and section 29 of the 1934 Act manifests an attempt to broaden the scope of the non-waiver provision. The legislative history is silent on this change, but it is quite clear that remedies under the 1934 Act extend to persons other than purchasers, *e.g.*, 15 U.S.C. 78i(e).

10. See cases cited Brief for Petitioner, p. 16 & n. 6.

11. *In the matter of Blair & Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 94020 (S.D.N.Y., June 1, 1973).

internal organization is concerned, Rule 347(b) is based on the Exchange Constitution, Article III, §§ 5, 6, as well as § 6(e) of the 1934 Act.

Precisely what constitutional rights are violated by arbitration is unclear from respondents' brief. The securities laws do not provide constitutional rights per se. The "agreement" referred to in § 6(a)(1) of the 1934 Act, 15 U.S.C. § 78f(1), which Congress indicated should "not be construed as a waiver of any constitutional right . . .," is the agreement of an exchange to comply with the Act and SEC rules and regulations. The only other right of constitutional dimension is respondents' alleged right to jury trial. But arbitration itself is always a waiver of a jury trial. Moreover, except for facts as to the dates of employment, amount of benefits, etc., all of which are available from Merrill Lynch's records, respondents have no facts which need to be found by a jury, predicated their right to recovery as flowing from a legal declaration of invalidity of Article 11.1.

B. There is No Fundamental Unfairness in Arbitration Proceedings.

Coupled with the argument on waiver of rights which respondents make is the concept that, for a variety of reasons, they will not receive a fair hearing in an Exchange arbitration, and will never have their day in court. Any attempt to relate this case to the due process issues in *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), must fail at the very outset.

The record is devoid of any evidence to support respondents' claim that they will be treated unfairly. The assumption that arbitration will be conducted in New York overlooks not only the practice of the Exchange, 2 CCH N.Y. Stock Exchange Guide ¶ 2492A, but also petitioners' agreement to arbitrate in California. 2R. Appendix E. The assumption that important due process rights, such as dis-

covery, will be denied, overlooks the fact that petitioner sought arbitration under California law which does provide for discovery, California Code of Civil Procedures § 1282.6, and other due process safeguards, California Code of Civil Procedure §§ 1282 *et seq.*

Lastly, and perhaps most importantly, respondents assume that an arbitration award is final and conclusive. The California statute, however, provides for *judicial* proceedings to confirm, vacate, or modify the award. California Code of Civil Procedure §§ 1285 *et seq.* So does the Federal Act, 9 U.S.C. § 10. That these proceedings would apply to the present dispute was made implicit in *Frame* when that court ordered arbitration. (App. 74). Respondents thus would have a full opportunity to have that issue decided in a judicial forum. In short, the due process issues which respondents raise are simply not present here.

Accordingly, it is respectfully submitted that the order and decision of the Court of Appeal should be reversed.

October 4, 1973.

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Appendix A

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

April 27, 1973

Before

HON. LUTHER M. SWYGERT, Chief Judge

HON. ROGER J. KILEY, Circuit Judge

HON. WALTER J. CUMMINGS, Circuit Judge

JAMES K. CULLINAN,

Plaintiff-Appellant,

vs.

**MERRILL LYNCH, PIERCE, FENNER & SMITH,
INC.,**

Defendant-Appellee.

No.

72-2046

**Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division**

(72 C 1724, Judge Will)

The plaintiff, a registered securities representative formerly employed by the defendant, brought this action on his own behalf and on behalf of "other former employees similarly situated" to challenge the forfeiture of his interest in the defendant's profit-sharing trust plan upon the voluntary termination of his employment with defendant to work for another securities dealer. The plaintiff claims that the forfeiture provisions of the plan constitute an unreasonable restraint of trade and enable the defendant to become unjustly enriched.

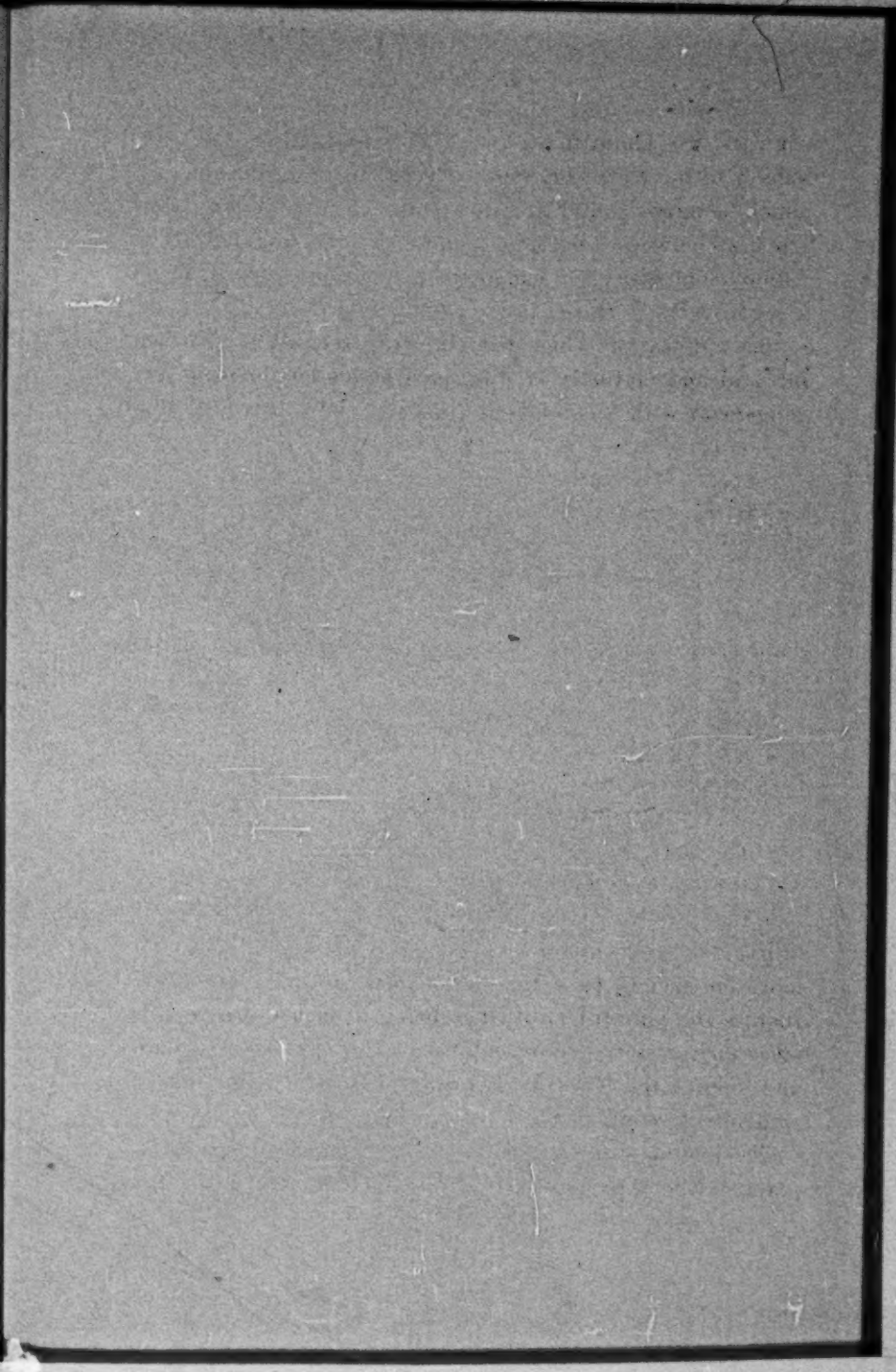
As a condition of his employment as a registered representative the plaintiff was required to and did execute and submit to the New York Stock Exchange an application, in which he agreed, inter alia, to refer to arbitration any controversy between him and a member firm arising out of his employment with such firm or the termination thereof. Such a controversy is raised in the complaint herein.

The application which the plaintiff executed became an integral and mutually binding part of his employment arrangement with the defendant, and the defendant is therefore entitled to enforce its provisions, including the requirement that controversies like the present one be settled by arbitration. *Dickstein v. duPont*, 443 F.2d 783 (1st Cir. 1971).

The plaintiff's agreement to arbitrate controversies arising out of his employment or the termination thereof is valid, irrevocable and enforceable. Federal Arbitration Act, Section 2, 9 U.S.C. § 2; *Dickstein v. duPont*, supra. The plaintiff has asserted no substantial grounds for the revocation of his agreement to arbitrate. His allegation that the forfeiture clause violates the federal antitrust laws is without merit. *Austin v. House of Vision, Inc.*, 404 F.2d 401 (7th Cir. 1969).

The Plaintiff has failed to allege facts sufficient to establish that his cause may be maintained as a class action. Moreover, the members of the proposed class would be no more entitled to have this action brought on their behalf than is the plaintiff entitled to bring it on his own behalf, since all registered representatives are required to execute and submit the N.Y.S.E. application in which they agree to arbitrate controversies such as this one.

The judgment of the District Court, dismissing the complaint without prejudice, is **AFFIRMED**.



No. 72-312

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In the Supreme Court of the United States

OCTOBER TERM, 1973

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
PETITIONER

v.

DAVID WARE, ET AL.

**ON WRIT OF HABEAS CORPUS TO THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE
DISTRICT**

BRIEF OF THE UNITED STATES AS AMICUS CURIAE

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In the Supreme Court of the United States

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No. 72-312

**MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
PETITIONER**

v.

DAVID WARE, ET AL.

**ON WRIT OF CERTIORARI TO THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA FOR THE FIRST APPELLATE
DISTRICT**

BRIEF OF THE UNITED STATES AS AMICUS CURIAE

QUESTION PRESENTED

The United States will discuss the following question:

Whether, where an employee of a member firm of the New York Stock Exchange has entered into an agreement to arbitrate any dispute relating to his employment, as required by a rule of the Exchange, the Securities Exchange Act of 1934 preempts the application to such an employment dispute of a California statute providing that actions for wages can be maintained without regard to arbitration agreements.

(1)

THE INTEREST OF THE UNITED STATES

At the Court's invitation, the United States filed a memorandum *amicus curiae* at the petition stage. The government has an interest in the issues raised by the parties, which concern the effect of the Securities Exchange Act of 1934 on the applicability of state law to rules of a stock exchange registered with and regulated by the Securities and Exchange Commission.

STATEMENT

Petitioner ("Merrill Lynch"), a securities broker-dealer registered with the Securities and Exchange Commission, is a member of several stock exchanges located in different states, including the New York Stock Exchange, located in New York. It has a profit-sharing plan for its employees containing a provision that any employee who voluntarily terminates his employment with Merrill Lynch forfeits his vested interest in the plan if he subsequently is employed by a competitor of Merrill Lynch or establishes a competitive business (A. 38).¹

Respondent David Ware, a California resident and a former registered representative of Merrill Lynch employed at one of its California offices, has been denied distribution of his earned profit-sharing credits under this forfeiture provision. Mr. Ware brought a class action in a state court in California, alleging that the forfeiture provision was invalid under California Business and Professions Code Section 16600 (Pet.

¹ "A." refers to the printed appendix. "Pet. Br.", or "Res. Br." refers to petitioner's or respondents' briefs. "Pet. A" refers to Appendix A of petitioner's brief.

Br. 4), which voids any contract to the extent that an individual is restrained from engaging in a lawful occupation.

Merrill Lynch petitioned for an order compelling arbitration of the dispute on the basis of a written agreement between it and Mr. Ware in which he agreed that any dispute arising out of his employment would be settled by arbitration in accordance with the rules of the Exchange (A. 53, 55-56; cf. Pet. A8). Rule 347(b) of the Exchange provides that any controversy between a registered representative and a member of the Exchange arising out of the representative's employment by a member thereof shall be settled by arbitration (Pet. A9).

The trial court denied the petition to compel arbitration, and the California Court of Appeal affirmed on the basis of Section 229 of the California Ann. Labor Code (Pet. Br. 5), which provides that actions for wages can be maintained without regard to arbitration agreements.

DISCUSSION

1. A federal law will not ordinarily be found to supersede or preempt application of a state law unless there is "such actual conflict between the two schemes of regulation that both cannot stand in the same area," or there is "evidence of a congressional design to preempt the field." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 141. A finding of preemption may be dictated by the nature of the regulated subject, *id.* at 142, by the existence of a pervasive and comprehensive scheme of federal

regulation that "requires a uniform and exclusive system of federal regulation" to fulfill the federal statutory purposes, *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 639, or by the presence of such a conflict with the federal statute or the federal regulatory scheme that application of the state law would frustrate the purpose of the federal law. *Colorado Anti-Discrimination Comm'n v. Continental Air Lines, Inc.*, 372 U.S. 714, 724; *Rice v. Chicago Board of Trade*, 331 U.S. 247, 253-255.

Under these principles, we submit that in the circumstances of this case, Section 229 of the California Ann. Labor Code has not been preempted by the Securities Exchange Act of 1934.

2. Prior to enactment of the Securities Exchange Act of 1934, the power of regulation of the nation's securities exchanges rested primarily with the exchanges themselves, subject to such limited and largely ineffectual state or local laws as might have borne upon their operations. The legislative history of that Act, engendered by the stock market crash of 1929, reveals that Congress concluded that the prevailing degree of reliance on self-regulation of the activities of exchanges and their members was inadequate, that their autonomy should be limited, and that a measure of federal regulation was required.² But Congress did not give the newly-created Securities and Exchange Commission total and exclusive power over

² See generally *Stock Exchange Practices*, Report of the Senate Committee on Banking and Currency, S. Rep. No. 1455, 73d Cong., 2d Sess.; S. Rep. No. 792, 73d Cong., 2d Sess.; H. Rep. No. 1383, 73d Cong., 2d Sess.

all exchange functions. Rather, the Act provided for substantial federal regulation of exchange activities relating to investor protection, fair dealing in securities, and fair administration of exchanges; in other respects it continued the application of state law to the exchanges and, subject to the constraints of federal and state law, permitted exchanges to continue to regulate themselves to a substantial extent.

In particular, the Act drew a significant distinction between the scope of authority left to the exchanges free of federal regulation with respect to "administration of their ordinary affairs," and the restricted authority permitted to the exchanges with respect to matters subject to Commission supervision that more directly affect the investing public. Thus, the Senate Committee's report stressed that under the Act "the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves." But "where * * * [exchanges] fail adequately to provide protection to investors * * * the Commission is authorized to step in and compel them to do so." S. Rep. No. 792, 73d Cong., 2d Sess. 13.²

The Act contains a general standard that, to obtain registration, an exchange must have rules that are "just and adequate to insure fair dealing and to pro-

² The intention was therefore one of "letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." Douglas, *Democracy and Finance*, 82 (Allen ed., 1940).

tect investors * * *." 15 U.S.C. 78f(d). In particular, a registered exchange is obliged to have rules that provide for disciplining its members for "conduct or proceeding inconsistent with just and equitable principles of trade" and that declare any violation of the Act or the Commission's rules or regulations thereunder to be such conduct. 15 U.S.C. 78f(b).

Otherwise, the Act left exchanges a zone of freedom and discretion as to their rules. Thus, exchanges are generally authorized under Section 6(e), 15 U.S.C. 78f(e), to promulgate and enforce rules "not inconsistent with * * * [the Act] and the applicable laws of the State in which * * * [the exchange] is located." Moreover, Section 19(b) of the Act, 15 U.S.C. 78s(b), which authorizes the Commission "to alter or supplement" exchange rules on twelve specified subjects and "similar matters" by rule or regulation or by order, may be regarded as implicitly authorizing exchanges to adopt rules on the enumerated matters, none of which is involved here.⁵

⁵ Before an exchange may be registered, it must agree to furnish "copies of any amendments to the rules of the exchange forthwith upon their adoption," Section 6(a)(4), 15 U.S.C. 78f(a)(4). Commission Rule 17a-8, 17 C.F.R. 240.17a-8, requires that each exchange submit to the Commission the text of "any proposed amendment or repeal of, or any addition to, its rules," including its constitution, articles of incorporation, by-laws, and stated policies, at least three weeks before any action is taken on the proposal.

⁶ This list encompasses—
 "Such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate

The Commission is authorized to act under Section 19(b) when it finds a change in an exchange's rules to be

necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange * * *.

Under Section 19(b), therefore, as the House Committee Report on the bill stated,

[t]he Commission is empowered, if the rules of the exchange in any important matter are not appropriate for the protection of investors

forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickets maintained by or with the consent of the exchanges, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters."

The Commission has recognized:

"It is clear from this language [of Section 19(b)] that Congress did not intend to empower this Commission to alter or supplement *all* rules of a national securities exchange. At the same time it is plain that the language 'such matters as' and 'similar matters' calls for a broad construction of the section." *In the Matter of the Rules of the New York Stock Exchange*, 10 S.E.C. 270, 294.

or appropriate to insure fair dealing, to order such changes in the rules after due notice and hearings as it may deem necessary. [H. Rep. No. 1383, 73d Cong., 2d Sess. 15. (emphasis supplied).]

In addition, the Commission has broad rulemaking authority under the Act to deal directly with certain other matters.* Accordingly, with respect to "any important matter," as the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs has recently observed,[†]

[t]he Commission's powers of direct rule making * * * and its "reserved" authority in section 19 are complementary. Taken together they provide the Commission with pervasive regulatory authority over and responsibility for the operations of exchange markets and the conduct of persons who use those markets.

Finally, although criminal sanctions were provided for violations of the Act or Commission rules or regulations, 15 U.S.C. 78ff(a), there are no such federal sanctions for violation of rules of an exchange.[‡]

* See, e.g., the Commission's authority to regulate exchange transactions concerning options under § 9(b) of the Act, 15 U.S.C. 78i(b); members trading for their own accounts, § 11(a), 15 U.S.C. 78k(a); hypothecating of customers' securities, § 8, 15 U.S.C. 78h.

† *Security Industry Study*, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, S. Doc. No. 93-13, 93d Cong., 1st Sess. 143.

‡ To the contrary, the Act merely provides that, to obtain registration, an exchange must file with the Commission an agreement "to enforce so far as is within its powers compliance by its members" with the Act and the Commission's rules and regulations thereunder. 15 U.S.C. 78f(a)(1).

3. Petitioner contends that application of Section 229 of the California Ann. Labor Code would lead to "disparate" results and would conflict with an exchange rule—Rule 347(b)—adopted under Section 6 of the Act, thus creating a conflict with the Congressional objective of self-regulation under the Act (Pet. Br. 8, 13). As the petitioner recognizes (Pet. Br. 22), however, neither the Securities Exchange Act nor any rule or regulation adopted thereunder by the Commission purports to establish arbitration as the generally-favored procedure for resolving all disputes between exchange members and their employees.⁹ In other words, there is no basis for suggesting that Rule 347(b) was required to implement the literal language of the Act or any Commission rule.

Moreover, an exchange rule like Rule 347(b), which, if applicable, would merely require the respondent to arbitrate his dispute with his employer, deals with one of the "ordinary affairs" of the exchange that, as we have shown (*supra*, p. 5), Congress did not intend were to concern the Commission; the relationship of such a rule to investor protection, fair dealing or fair exchange administration—which are the standards under Section 19(b)—is extremely attenuated and peripheral, if it exists at all. Accordingly, the Commission would have no jurisdiction

⁹ Petitioner's reliance (Pet. Br. 17) upon a passing reference to arbitration in *Silver v. New York Stock Exchange*, 373 U.S. 341, 354, n. 9, is misplaced, for there the Court was dealing, in another context, with exchange rules concerning relationships between exchange members and nonmember firms dealing in over-the-counter securities. See *infra*, pp. 11-12 n. 13.

under Section 19(b) to modify or review the operation of Rule 347(b).¹⁰

Neither the Act nor any Commission rule or regulation purports to displace state law or to require nation-wide uniformity as to an exchange's ordinary affairs. To the contrary, in the Act Congress several times indicated its intention that state law should continue to apply where the Act does not.¹¹ As we have noted, under Section 6(c) an exchange is authorized to adopt and enforce rules not inconsistent with the Act "and the applicable laws of the State in which it

¹⁰ In view of the Commission's lack of jurisdiction concerning such matters, its silence when Rule 347 was submitted in 1958 did not constitute "authoritative approval" of Rule 347 (b), as petitioner contends (Pet. Br. 18).

¹¹ For example, Section 28(a) provides that the rights and remedies provided by the Act are "in addition to any and all other rights and remedies that may exist at law or in equity," and further provides that nothing in the Act "shall affect the jurisdiction of the securities commission * * * of any state * * * insofar as it does not conflict with" the Act or the Commission's rules and regulations thereunder. 15 U.S.C. 78bb(a).

In addition, Section 28(b) provides in pertinent part:

"Nothing in this chapter shall be construed to modify existing law * * * (2) with regard to the binding effect of * * * [exchange] action [to settle disputes between its members] on any person who has agreed to be bound thereby."

The parties (Pet. Br. 15, Res. Br. 16-20) disagree about the proper applicability to the instant case of the "nonwaiver" provision of Section 29(a) of the Act, 15 U.S.C. 78cc(a), which provides:

"Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

If, as we believe, the exchange rule in issue here is not "required" by the Act nor by "any rule or regulation thereunder," Section 29(a) is inapplicable.

is located.”¹² There is nothing in the federal regulatory scheme to indicate that the activities of exchanges and their members should not continue generally to conform to applicable state and local law as they were required to do before the Act, where such local standards are not contrary to the express requirements of federal law, the rules or regulations of the Commission, or the regulatory scheme that the Act establishes.

The legislative history and express language of the Act show that a basic intent of the statute was protection of the investing public through the “maintenance of fair and honest markets.” See Section 2 of the Act, 15 U.S.C. 78b. Exchange rules that are not substantially related to the statutory objectives should not be considered paramount to otherwise conflicting statutes. Compare *Silver v. New York Stock Exchange*, 373 U.S. 341.¹³ Rule 347(b), as applied here, cannot be said to be related to the regulatory objectives of the statute in any but the most indirect manner, and there-

¹² Thus, if the law of New York, where the Exchange is located, contained a provision like Section 229 of the California Ann. Labor Code, there would be even less basis for a claim of preemption.

¹³ The parties have made frequent reference to *Silver v. New York Stock Exchange*, 373 U.S. 341, where this Court considered the question whether the federal Securities Exchange Act of 1934 had impliedly repealed the federal antitrust laws. The preemption issue presented here, however, is governed, not by the principles concerning implied repeal and conflict between different laws adopted by Congress at different times, but by this Court's separate, if analogous, body of authority concerning the sensitive interrelationship between laws adopted by separate, coordinate sovereignties, federal and state. More

fore it is not the type of exchange self-regulation within the scope and purposes of the Securities Exchange Act that might oust conflicting provisions of state law. If the exchange rule in issue before this Court did involve a matter sufficiently important to the Act's objectives to be within the ambit of the Commission's pervasive regulatory oversight as delineated by the Act, state law in conflict with the rule would be preempted. However, the method for resolving disputes about the eligibility of former employees of a member firm to participate in a profit-sharing plan is not such a matter.

so than with the case of implied repeal, "an unexpressed purpose to nullify" state law "is not lightly to be attributed to Congress," *Parker v. Brown*, 317 U.S. 341, 351, and a claim of conflict must be, if anything, even more persuasive where state law is concerned than where a claim of implied repeal of another federal law is made. *Penn Dairies, Inc. v. Milk Control Comm'n*, 318 U.S. 261, 275. As noted in the Memorandum for the United States as *amicus curiae*, p. 8, n. 6, filed in opposition to the petition in this case, the Commission and the Antitrust Division of the Department of Justice have different positions concerning the applicability of this Court's decision in *Silver* to matters subject to Commission oversight. Both agree, however, that *Silver* generally recognizes the continued applicability of the antitrust and other laws to exchange activities that are not subject to Commission oversight, and both agree that this case does not require the Court to consider further the issues raised in *Silver*.

CONCLUSION

For the foregoing reasons the judgment of the court of appeal should be affirmed.

Respectfully submitted.

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THE UNIVERSITY OF CHICAGO PRESS

Syllabus

MERRILL LYNCH, PIERCE, FENNER & SMITH,
INC. v. WARECERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, FIRST
APPELLATE DISTRICT

No. 72-312. Argued October 9-10, 1973—Decided December 4, 1973

When respondent voluntarily terminated his employment as an account executive in petitioner securities broker's San Francisco office for a similar position with a competitor, petitioner determined, pursuant to a forfeiture clause of its employees' profit-sharing plan, that respondent, by entering competitive employment, had forfeited all rights to the plan's benefits. Respondent sought a declaratory judgment in a California state court that the forfeiture clause was unlawful under § 16600 of the California Business and Professions Code, which invalidates every contract restraining a person from engaging in a lawful business. Petitioner answered, *inter alia*, that a condition of respondent's employment with petitioner was approval by the New York Stock Exchange; that respondent, at the time of his employment, applied on an Exchange form for such approval, as required by Exchange Rule 345 (a)(1), pledging to abide by Exchange rules; and as required by Rule 347 (b) agreed to submit to arbitration any controversy arising out of termination of his employment. On petitioner's appeal from the denial of its petition for an order directing arbitration, the California Court of Appeal held that a written agreement to arbitrate did exist, but that the forfeiture clause of the profit-sharing plan was invalid as in restraint of trade under California law when applied to California residents, and petitioner's contributions under the plan were wages under provisions of the California Labor Code giving wage earners a right of action for wages due and unpaid despite any private agreement to arbitrate. *Held*: Exchange Rules 345 (a)(1) and 347 (b), promulgated as self-regulatory measures pursuant to § 6 of the Securities Exchange Act of 1934 (the Act), and respondent's pledge to abide by those rules, do not pre-empt the avenues of wage relief otherwise available to respondent under California law. Pp. 125-140.

(a) Rule 347 (b) does not fall under the Exchange's mandate to protect the investing public and to insure just and equitable trade practices set forth in §§ 6 (d) and 19 (b) of the Act, so as

to require pre-emption of contrary state law by such rule, there being nothing in the Act or any SEC rule or regulation specifying arbitration as a favored means of resolving employer-employee disputes, and it being clear that Rule 347 (b) would not be subject to the SEC's modification or review under § 19 (b). Pp. 134-136.

(b) Rule 347 (b) cannot be categorized as part of a need for uniform national regulation, there being no revelation in the Act or in any SEC regulation that nationwide uniformity of an exchange's housekeeping affairs is necessary, and it not being shown that national uniformity in the area of wage claims is vital to federal securities policy. Pp. 136-137.

(c) The "applicable state laws" referred to in § 6 (e) of the Act, which subjects exchange rules to a requirement of consistency with the Act, "and the applicable laws of the State in which it is located," are not in this instance, merely because the New York Stock Exchange is in New York City, the laws of New York so as to require the California court to apply New York law compelling arbitration of this dispute and validating the forfeiture clause of the profit-sharing plan, since § 6 (c) has no independent existence creating some sort of spurious uniformity of application for all States, but merely requires that any exchange rule adopted outside the Act's context comport with the laws of the State in which the exchange is located. Pp. 137-139.

(d) Where California has manifested a strong statutory policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relationship, that policy should prevail absent any interference with the federal regulatory scheme; in this case there is not only no such interference, but the Act's structure manifests a congressional intent that state policies in this area should operate vigorously. Pp. 139-140.

(e) Even though petitioner's profit-sharing plan is open to all eligible employees in the United States, and respondent's employment and petitioner's business are interstate, the application of the California law would not unduly burden interstate commerce. P. 140.

24 Cal. App. 3d 35, 100 Cal. Rptr. 791, affirmed.

BLACKMUN, J., delivered the opinion of the Court, in which all Members joined, except STEWART, J., who took no part in the decision of the case.

William H. Orrick, Jr., argued the cause for petitioner. With him on the briefs was *W. Reece Bader*.

Joseph C. Barton argued the cause for respondent. With him on the brief was *Thomas E. Feeney*.*

MR. JUSTICE BLACKMUN delivered the opinion of the Court.

This case presents the question whether certain rules of the New York Stock Exchange, promulgated as self-regulating measures pursuant to § 6 of the Securities Exchange Act of 1934, 48 Stat. 886, 15 U. S. C. § 78f, and a broker's employee's pledge to abide by those rules, preempt avenues of wage relief otherwise available to the employee under state law. The California Court of Appeal answered this in the negative. 24 Cal. App. 3d 35, 100 Cal. Rptr. 791 (1972). Because of the significance of the question in the area of federal-state relations, we granted certiorari. 410 U. S. 908 (1973).

I

Respondent, David Ware, in July 1958 entered the employ of petitioner Merrill Lynch, Pierce, Fenner & Smith, Inc., a New York corporation, as a registered representative or "account executive" in the petitioner's San Francisco office. Ware worked there continuously until March 1969 when he voluntarily terminated that relationship and accepted a similar position in San Francisco with one of Merrill Lynch's competitors.

Merrill Lynch is a broker-dealer in securities and is a member-corporation of the New York Stock Exchange. Since prior to 1958, the firm has had a noncontributory Profit-Sharing Plan for its employees in the United States.

*Solicitor General Bork, Gerald P. Norton, David Ferber, and Richard E. Nathan filed a brief for the United States as *amicus curiae* urging affirmance.

Under the Plan an employee may have allocated to his account both vested and unvested units, as therein described. Article 11 of the Plan relates to "Forfeiture of Benefits" upon the happening of specified events. One such event is competitive activity:

"11.1 A Participant who, in the determination of the Committee, voluntarily terminates his employment with the Corporation or provokes his termination and engages in an occupation which is, in the determination of the Committee, competitive with the Corporation, or any affiliate or subsidiary thereof, shall forfeit all rights to any benefits otherwise due or to become due from the Trust Fund with respect to units credited for fiscal years subsequent to the fiscal year ended December 30, 1960."

The Committee referred to is provided for by the Plan's Art. 1. It has not less than five nor more than nine persons (not necessarily employees) appointed by Merrill Lynch and serving "at the pleasure of the Corporation." Article 1.2 states that the Committee "shall administer the Plan" and "shall determine any questions arising in the administration, interpretation and application of the Plan, which determination shall be conclusive and binding on all persons."

At the time Ware terminated his employment with Merrill Lynch in March 1969, both vested and unvested units were allocated to his account. Upon his departure, the Committee, pursuant to Art. 11.1, determined that Ware, by entering competitive employment, had forfeited all rights to benefits due or to become due him under the Plan.

In January 1970 Ware filed this class action in California state court against Merrill Lynch and the members of the Committee. The class purported to consist of Ware and all other similarly situated former

Merrill Lynch employees in California. Declaratory relief was sought to the effect that Art. 11.1 was "unlawful and void under applicable California law," and that the defendants were obligated to pay all vested units credited from December 30, 1960, to the date of termination of employment.

Although the statute was not cited in the complaint, the parties appear to agree that the suit rested principally on § 16600 of the California Business and Professions Code. This reads:

"Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

In its answer, Merrill Lynch alleged that the provisions of Art. 11.1 were a reasonable restraint on competition under the laws of New York or of the United States; that, pursuant to Art. 22.1¹ of the Plan, it was to be construed according to the laws of New York; that under New York law Art. 11.1 is lawful, valid, and enforceable; that a condition of Ware's employment with Merrill Lynch was approval by the New York Stock Exchange; that Ware, at the time of his employment in 1958, executed a written application, on an Exchange form, for approval of his employment as a registered representative, as required by the Exchange's Rule 345 (a)(1);² that by ¶ 30 (j) of that form Ware agreed that any controversy with a member arising out of the

¹"22.1 The validity of the Plan or of any of the provisions thereof shall be determined under and shall be construed according to the laws of the State of New York."

²"Rule 345. (a) No member or member organization shall

"(1) permit any person to perform regularly the duties customarily performed by a registered representative, unless such person shall have been registered with and is acceptable to the Exchange"

termination of his employment would be settled by arbitration at the instance of any party;³ that the Exchange approved the application; that Ware's sole remedy was arbitration; and that a declaration that Art. 11.1 was invalid under the laws of California would cause Merrill Lynch to discriminate in the administration of the Plan and would deprive it of due process of law.

Merrill Lynch, invoking § 1281.2 of the California Code of Civil Procedure,⁴ petitioned the state court for an

³ Paragraph 30 (j) of the Exchange form reads:

"(j) I agree that any controversy between me and any member organization arising out of my employment or the termination of my employment by and with such . . . member organization shall be settled by arbitration at the instance of any such party in accordance with the Constitution and rules then obtaining of the New York Stock Exchange."

Paragraph 30 (d) of the same form reads in part:

"(d) I have read the Constitution and Rules of the Board of Governors of the New York Stock Exchange and, if approved, I hereby pledge myself to abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange as the same have been or shall be from time to time amended, and by all rules and regulations adopted pursuant to the Constitution, and by all practices of the Exchange."

Rule 347 (b) of the New York Stock Exchange, adopted in April 1958, prior to Ware's employment, provides:

"(b) Any controversy between a registered representative and any . . . member organization arising out of the employment or termination of employment of such registered representative by and with such . . . member organization shall be settled by arbitration, at the instance of any such party, in accordance with the arbitration procedure prescribed elsewhere in these rules."

It is thus apparent that § 30 (j) of the form follows the language of the Exchange's Rule 347 (b).

⁴ "§ 1281.2 Order to arbitrate controversy; petition; determination of court

"On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall

order directing arbitration pursuant to the above-quoted § 30 (j) and Ware's pledge, contained in his application for approval of employment, that he would "abide by the Constitution and Rules of the Board of Governors of the New York Stock Exchange" and that he submitted himself "to the jurisdiction of such Exchange."

Ware opposed arbitration on the grounds that no contract to arbitrate existed between him and Merrill Lynch; that if an agreement to this effect existed, it was a contract of adhesion; and that, since § 16600 made the forfeiture provision illegal under California law, it was not arbitrable.

The state trial court, by minute order, denied the petition to compel arbitration.

Merrill Lynch then appealed. The California Court of Appeal held that a written agreement to arbitrate did exist; that the Exchange form was "a contractual agreement"; and that the "approval and registration by Merrill Lynch made the application a contract between the parties." 24 Cal. App. 3d, at 40-41, 100 Cal. Rptr., at 795-796. The court went on to hold, however, that the forfeiture clause was invalid and unenforceable under California law, when applied to California residents, as being in restraint of trade. 24 Cal. App. 3d, at 42-43, 100 Cal. Rptr., at 796-797. Cited as supporting authorities were *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971), where the same forfeiture clause was held ineffective under California law, but where the court also held that an

order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that:

"(a) The right to compel arbitration has been waived by the petitioner; or

"(b) Grounds exist for the revocation of the agreement. . . ."

enforceable agreement to arbitrate existed,⁵ and *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal. 2d 239, 398 P. 2d 147 (1965).

Finally, the Court of Appeal, while taking note of California's "strong public policy" favoring arbitration, held that Merrill Lynch's contributions under its Profit-Sharing Plan were wages, within the meaning of §§ 200⁶

⁵ In *Frame*, decided only five months earlier, the same California Court of Appeal reversed a trial court's order denying arbitration and thus seemingly arrived at an ultimate result opposite to that reached in the present case. The court held, 20 Cal. App. 3d 663, 671-673, 97 Cal. Rptr. 811, 813-815, that *Frame* (like *Ware*) had made an agreement to arbitrate; that there was no basis for using the doctrine of adhesion to avoid arbitration; that the forfeiture provision of Art. 11.1 was ineffective under § 16600; that the agreement's provision that New York law was to apply "must not be allowed to defeat" the policy of § 16600; that, however, the entire contract was not necessarily unlawful; and that a

"latent question exists as to whether the agreements of the parties may be construed as applying only to such permissible subjects of restraint as breaches of confidence and misappropriation of trade secrets. Other questions may be raised as to the time and circumstances of respondent's employment and the amount of any benefits earned and remaining unpaid. All of these matters, whether they involve questions of law or questions of fact are in the first instance properly subject to arbitration." 20 Cal. App. 3d, at 673, 97 Cal. Rptr., at 815.

But no mention was made in *Frame* of §§ 200 and 229 of the State's Labor Code, see nn. 6-7, *infra*, and, as the court later said in *Ware*, 24 Cal. App. 3d 35, 43, 100 Cal. Rptr. 791, 797, "[t]he *Frame* court did not consider the effect of section 229 of the Labor Code on the arbitration agreement." Apparently, neither side in *Frame* sought review by the California Supreme Court.

⁶ "§ 200. Definitions

"As used in this article: (a) 'Wages' includes all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."

and 229⁷ of the California Labor Code, and that § 229 gave Ware "the right to bring his claim in court in spite of any agreement to arbitrate." 24 Cal. App. 3d, at 43-44, 100 Cal. Rptr., at 797-798. Merrill Lynch's petition for hearing by the Supreme Court of California was denied without opinion. See 24 Cal. App. 3d, at 45.

II

The broad issue thus presented to us is the extent to which authority delegated under a federal regulatory statute pre-empts state law. Specifically, we are concerned with the questions (a) whether, in the context of the present case, § 229 of the California Labor Code, which would preclude compulsory arbitration of wage disputes, is ineffective under the Supremacy Clause; (b) whether § 16600 of the California Business and Professions Code unduly interferes with federal regulation of the securities industry; and (c) whether the California legislation unconstitutionally burdens interstate commerce.

In order to resolve these questions, we think it necessary to review the principles of stock exchange preemption delineated in this Court's decision a decade ago in *Silver v. New York Stock Exchange*, 373 U. S. 341 (1963), and to examine the genesis of the federal Act and of the California statute.

⁷ "§ 229. Actions to enforce payment of wages; effect of arbitration agreements

"Actions to enforce the provisions of this article for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement to arbitrate. This section shall not apply to claims involving any dispute concerning the interpretation or application of any collective bargaining agreement containing such an arbitration agreement."

Section 229 was added to the Code in 1959. Cal. Stats. 1959, c. 1939, p. 4532.

A. In *Silver* the Court considered whether, and to what extent, the federal antitrust laws apply to securities exchanges regulated by the 1934 Act. It held that the mere passage of the Act did not effect, *pro tanto*, a repeal of the federal antitrust laws, but that particular instances of exchange regulation that fall within the scope and purposes of the Act may be justified and will be upheld against antitrust challenge. *Id.*, at 357-361. With respect to the specific question there presented, it was clear that the New York Stock Exchange had exercised its "tremendous economic power," *id.*, at 361, against two nonmembers by discontinuing their direct-wire telephone connections with members of the Exchange without notice, hearing, or statement of reasons. It was the Court's view, under the circumstances, that procedural guarantees were necessary in order to protect against the possibility of proscribed antitrust practices and to provide the "extremely beneficial effect in keeping exchange action from straying into areas wholly foreign to the purposes of the Securities Exchange Act." *Id.*, at 362. See also, *Ricci v. Chicago Mercantile Exchange*, 409 U. S. 289, 300-301 (1973).

In contrast with *Silver*, we are not confronted here with conflicting federal regulatory schemes. The present controversy concerns the interrelationship between statutes adopted, respectively, by the Federal Government and a State. The analytical framework of *Silver* is instructive, nonetheless. There the Court reviewed carefully the securities exchange regulatory scheme that Congress had adopted in order to identify the character and purposes of the Act and the extent to which instances of exchange self-regulation were necessary to the furtherance of congressional aims and objectives. 373 U. S., at 349-361. It was mindful, also, of the purposes behind the conflicting statutes which, in that case, were the

antitrust laws. So here, we may not overlook the body of law relating to the sensitive interrelationship between statutes adopted by the separate, yet coordinate, federal and state sovereignties. Our analysis is also to be tempered by the conviction that the proper approach is to reconcile "the operation of both statutory schemes with one another rather than holding one completely ousted." *Id.*, at 357.^{*} The principle that emerged from *Silver*, and the premise upon which the Court based its judgment, was that conflicting law, absent repealing or exclusivity provisions, should be pre-empted by exchange self-regulation "only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act." *Id.*, at 361.

B. The Securities Exchange Act of 1934, as amended, 15 U. S. C. §§ 78a to 78hh-1, "regulates securities markets and the business of securities brokers and dealers." Report of Special Study of Securities Markets of the Securities and Exchange Commission, H. R. Doc. No. 95, pt. 1, 88th Cong., 1st Sess., 3 (1963). Two types of regulation are reflected in the Act. Some provisions impose direct requirements and prohibitions. Among these are mandatory exchange registration, restrictions on broker and dealer borrowing, and the prohibition of manipulative or deceptive practices. Other provisions are flexible and rely on the technique of self-regulation to achieve their objectives. *Ibid.* Supervised self-regulation, although consonant with the traditional private governance of exchanges, allows the Government to

^{*} This approach is supported by decisions extending back to the turn of the century. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U. S. 132, 142 (1963); *Huron Portland Cement Co. v. City of Detroit*, 302 U. S. 440 (1960); *International Assn. of Machinists v. Gonzalez*, 356 U. S. 617 (1958); *Union Brokerage Co. v. Jensen*, 322 U. S. 202 (1944); *Savage v. Jones*, 225 U. S. 501 (1912).

monitor exchange business in the public interest.* Mr. JUSTICE DOUGLAS, when he was Chairman of the Securities and Exchange Commission, observed that this permits the exchanges to "take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." W. Douglas, *Democracy and Finance* 82 (J. Allen ed. 1940).

The Act provides for stock exchanges to be registered by the Commission. § 6, 15 U. S. C. § 78f. It outlaws securities transactions conducted on unregistered exchanges. § 5, 15 U. S. C. § 78e. It conditions registration on a showing that the exchange has rules that are "just and adequate to insure fair dealing and to protect investors." § 6 (d), 15 U. S. C. § 78f (d). An exchange seeking registration must also meet other requirements. It must agree "to enforce so far as is within its powers compliance by its members" with the

* The first attempt at exchange regulation arose after the panic of 1907 when, in response to public concern over speculation, President Theodore Roosevelt urged Congress to take action. 42 Cong. Rec. 1347, 1349 (1908). Nothing of significance happened, however, until after the 1929 stock market crash. It became apparent that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto." Securities Exchange Act of 1934, § 2, 15 U. S. C. § 78b. Self-regulation was adopted as a means of policing the exchanges. The tradition, as has been noted, had been one of self-governance; the financial community was strongly opposed to governmental control of daily exchange business; and the task was deemed to be of such magnitude that Government simply could not regulate effectively every aspect of the industry. Comment, 48 Minn. L. Rev. 597-598 (1964); 2 L. Loss, *Securities Regulation* 1175-1176 (1961), and 5 *id.*, at 3138-3139 (1969).

Act and the Commission's rules and regulations thereunder. § 6 (a)(1), 15 U. S. C. § 78f (a)(1). It must include in its rules a provision for the disciplining of a member "for conduct or proceeding inconsistent with just and equitable principles of trade." § 6 (b), 15 U. S. C. § 78f (b). And it must supply to the Commission copies of its constitution, articles of incorporation, and bylaws, and such data or other information as the Commission may require "as being necessary or appropriate in the public interest or for the protection of investors." § 6 (a)(3) and (2), 15 U. S. C. § 78f (a)(3) and (2).

The Commission's direct authority with respect to exchange self-regulation is supervisory. Apart from its responsibilities in registering exchanges, the Commission may "alter or supplement" the rules of an exchange if such action is "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." § 19 (b), 15 U. S. C. § 78s (b).¹⁰ This authority, however, relates to 12 designated subject areas and "similar matters." *Ibid.* As a consequence, some exchange rules are not subject to direct Commission scrutiny, *In re Rules of the New York Stock Exchange*, 10 S. E. C. 270, 294 (1941), and, instead, if they do not operate contrary to the interests of insuring fair dealing and protecting investors, would kindle no federal curiosity and would serve no identifiable public purpose. It is to be noted, moreover, that the Commission has exercised its direct supervisory power

¹⁰ The Commission also has broad rulemaking power under the Act. See, for example, §§ 8, 9, and 11, 15 U. S. C. §§ 78h, 78i, and 78k. No question is presented in this case as to the authority of the Commission to promulgate rules affecting the operation of stock exchanges.

sparingly. Securities Industry Study, Report of the Subcommittee on Securities, Committee on Banking, Housing and Urban Affairs, S. Doc. No. 93-13, p. 180 (1973).

Apart from registration and direct Commission supervision, the only other qualification on exchange autonomy is the statutory requirement that any rules promulgated and enforced by an exchange not be "inconsistent with this [Act] and the rules and regulations thereunder and the applicable laws of the State in which it is located." § 6 (c), 15 U. S. C. § 78f (c).

From this review of relevant portions of the Act, it is apparent that Congress accorded maximum scope to self-regulation, and reposed powers in the Commission "to be exercised as needed but in such manner as to allow maximum initiative and responsibility to the self-regulators." Report of the Special Study, *supra*, pt. 4, p. 726. In the words of the Senate Report issued at the time of enactment,

"Thus the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so." S. Rep. No. 792, 73d Cong., 2d Sess., 13 (1934).

It is thus clear that the congressional aim in supervised self-regulation is to insure fair dealing and to protect investors from harmful or unfair trading practices. To the extent that any exchange rule or practice contravenes this policy, or any authorized rule or regulation under the Act, the rule may be subject to appropriate federal regulatory supervision or action. Correspondingly, any rule or practice not germane to fair dealing

or investor protection would not appear to fall under the shadow of the federal umbrella; it is, instead, subject to applicable state law.

C. On the other side are the California statutes. By the addition of § 229 to its Labor Code in 1959 California codified for the wage earner, with the solitary collective-bargaining-agreement exception, a right of action to recover due and unpaid wages from his employer, regardless of the existence of any private agreement to arbitrate. Selected 1959 Code Legislation, 34 Cal. St. B. J. 581, 706-707. This was due, apparently, to the legislature's desire to protect the worker from the exploitative employer who would demand that a prospective employee sign away in advance his right to resort to the judicial system for redress of an employment grievance. The statute's legislative history is sparse, but the exception carved out for collective-bargaining disputes provides the obvious conclusion that it was the individual, nonunion, and otherwise unprotected wage earner who was the intended beneficiary of the State's grace in providing this remedy. This conclusion is fortified by the fact that § 200 (a) of the Code defines "wages" broadly to include "all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation." And the California court itself has noted "the established policy . . . of protecting and promoting" the right, " 'favored' in the law," of the wage earner "to all wages lawfully accrued to him." *City of Ukiah v. Fones*, 64 Cal. 2d 104, 108, 410 P. 2d 369, 371 (1966). It may be, too, that the legislature felt that arbitration was a less than adequate protection against awarding the wage earner something short of what was due compensation. In any event, there is the harder substance of California case law. In *Local 659 v. Color Corp. of America*, 47 Cal. 2d 189, 302 P. 2d

294 (1956), decided prior to the addition of § 229 to the Labor Code, the court held that the then § 1280 of the State's Code of Civil Procedure, providing for the enforcement of an arbitration clause in a contract and characterizing it as "irrevocable," was subject to waiver or mutual rescission. The statute provided that arbitration was required "save upon such grounds as exist at law or in equity for the revocation of any contract."¹¹ California, thus, does not exclude a remedy available at law or in equity for the revocation of any contract that happens to contain an arbitration clause.

This conclusion as to the broad and liberal intendment of § 229 is reinforced by the Court of Appeal's observation in the present case, 24 Cal. App. 3d, at 44-45, 100 Cal. Rptr., at 798, that the State's Arbitration Act, revised in 1961, embraced no attempt to change the right of action first accorded the wage earner only two years earlier in 1959. The record is clear, moreover, that legislative attention was drawn in 1961 to § 229. The California Senate was asked to reconsider its unanimous vote in favor of the Arbitration Act on the ground that there was legislative uncertainty as to its effect upon § 229. 2 Journal of the Senate 2215-2218 (May 4, 1961). The motion to reconsider was later waived, and the bill was transmitted to the Assembly. *Id.*, at 2287 (May 8, 1961). Thus, the Senate had in mind the rights accorded wage earners by § 229, and those rights were placed in focus with the "historical friendliness of California to the institution of arbitration." Feldman, *Arbitration Modernized—The New California Arbitration Act*, 34 So. Calif. L. Rev. 413, 414 (1961). Section 229 thus survived subsequent legislative scrutiny and has now mani-

¹¹ Section 1280 was repealed and replaced in 1961 to make the saving clause in § 1281 now read, "save upon such grounds as exist for the revocation of any contract." Cal. Stats. 1961, c. 461, pp. 1540-1541, §§ 1 and 2.

festated itself as an important state policy through interpretation by the California courts.

One might also consider, as the respondent suggests here, the California antitrust policies embodied in § 16600 of the Business and Professions Code, quoted, *supra*, at 121. This statute has been in effect for many years and is well entrenched in case law and in commentary.¹² We need not pursue in depth the policy considerations supporting this statute because, in our judgment, § 16600, standing alone and apart from § 229, under existing case law, would not provide the necessary support to uphold a challenge to arbitration. Our inclination in this respect is buttressed by the different results reached by the California Court of Appeal in this case and in *Frame*, *supra*, respectively. In *Frame*, the court decided that the "strong [California] public policy" against restraining one from engaging in a lawful business foreclosed the application of the more permissive New York law to the forfeiture provision of the profit-sharing plan. Although California public policy thus served to nullify the contract's forfeiture provision, arbitration, nonetheless, was not precluded. By way of contrast, the present case provoked a claim under § 229, in addition to Ware's reliance on § 16600, in the face of Merrill Lynch's motion to compel arbitration. The California court declared again that the forfeiture clause was invalid but, in addition, held that the arbitration clause was unenforceable, relying on § 16600 and § 229, respectively. With this analysis of the state statutes made by the California court, we rest on that court's interpretation of state law and do not, and in fact cannot, disturb its determination that under those statutes arbitration will lie in the one instance but not in the other.

¹² See citations following § 16600 in West's Ann. Calif. Bus. & Prof. Code 41 *et seq.*

With this background, we turn to specific arguments advanced by the petitioner here.

III

A. Merrill Lynch suggests that Rule 347 (b) of the New York Stock Exchange, set forth in n. 3, *supra*, falls under the Exchange's mandate to protect the investing public and to insure just and equitable trade practices.¹⁸ Its contention is that confidence in the industry and in the integrity and ability of its members has been jeopardized by failures of major brokerage houses with consequent substantial losses to the public. Investor confidence would be further undermined, it is said, by protracted litigation between member firms and their employees over disputes that arise out of employment relationships; public airing of every claim of this kind will erode confidence in the market; and arbitration, on the other hand, will internalize these disputes and provide an expeditious and economical method of resolution by arbitrators familiar with industry customs and practices.

As is seen by our discussion above, §§ 6 (d) and 19 (b) of the Act, 15 U. S. C. §§ 78f (d) and 78s (b), establish the measure of congressionally delegated authority for self-regulation in the national interest. Section 6 (d) requires that exchange rules be "just and adequate to insure fair dealing and to protect investors." Section 19 (b) gives the Commission limited power over certain types of exchange rules "for the protection of investors

¹⁸ The phrase "just and equitable trade practices" would be inappropriately used to justify Rule 347 (b). This is because the standard refers to rules adopted pursuant to § 6 (b) of the Act, 15 U. S. C. § 78f (b), providing for the expulsion, suspension, or disciplining of a member "for conduct or proceeding inconsistent with just and equitable principles of trade." Arbitration is not the type of disciplinary rule that § 6 (b) contemplates.

or to "insure fair dealing in securities" or to "insure fair administration" of the exchanges.¹⁴ Measured by these standards, we conclude that the policy arguments advanced by Merrill Lynch do not require pre-emption of contrary state law by Rule 347 (b).

To begin with the obvious, there is nothing in the Act and there is no Commission rule or regulation that specifies arbitration as the favored means of resolving employer-employee disputes.¹⁵ It is also clear that Rule 347 (b) would not be subject to the Commission's modification or review under § 19 (b). The United States, as *amicus*, concedes as much, and we conclude, as the Government suggests, that the relationship between compulsory employer-employee arbitration and fair dealing and investor protection is "extremely attenuated and peripheral, if it exists at all." Brief for the United States 9. Merrill Lynch has not alleged that arbitration will effect fair dealing or result in investor protection. It suggests only that investor confidence not be shaken

¹⁴ As noted above, *supra*, at 129, the Commission's review power over exchange rules is circumscribed by certain subject matter limitations explicitly enumerated in § 19 (b). None of the subject matter categories suggests that the Commission has review authority with respect to a rule requiring arbitration of employer-employee disputes.

¹⁵ This Court and other federal courts, of course, have endorsed the suitability of arbitration to resolve federally created rights. *Wilko v. Swan*, 348 U. S. 427, 431 (1953); *Coenen v. R. W. Pressprich & Co.*, 453 F. 2d 1209 (CA2), cert. denied, 406 U. S. 949 (1972). See other cases cited by Mr. Justice WHITE in his dissenting opinion in *U. S. Bulk Carriers, Inc. v. Arguelles*, 400 U. S. 351, 374-375 (1971). These cases, however, concern situations where a federal act itself has provided for arbitration. Yet in *Wilko v. Swan* an investor customer's agreement to arbitrate was held void under § 14 of the Securities Act of 1933, 15 U. S. C. § 77n, notwithstanding the provisions of § 3 of the Arbitration Act, 9 U. S. C. § 3. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U. S. 395 (1967).

further by public airing of employer-employee disputes. There is no explanation of why a judicial proceeding, even though public, would undermine investor confidence. It is difficult to understand why muffling a grievance in the cloakroom of arbitration would prevent lessening of confidence in the market. To the contrary, for the generally sophisticated investing public, market confidence may tend to be restored in the light of impartial public court adjudication. Furthermore, it should be apparent that, so far as investor confidence is concerned, compulsory arbitration of an employee-employer grievance is no substitute for direct effective disciplinary action against any abusive exchange practice. Other rules of the exchange serve this very function. Rule 345 (b), for example, permits the exchange to disapprove, and thereby to forestall, the employment of any person, and Rule 345 (d) spells out punitive measures for "conduct inconsistent with just and equitable principles of trade," or "acts detrimental to the interest or welfare of the Exchange," or "conduct contrary to an established practice of the Exchange." These measures, designed to insure fair dealing and to protect investors, are of the kind directly related to the Act's purposes and ordinarily would not be expected to yield to provisions of state law.

B. Rule 347 (b) cannot be categorized, as the petitioner suggests, as part of a need for uniform national regulation. There is no revelation in the Act or in any Commission rule or regulation that nationwide uniformity of an exchange's housekeeping affairs is necessary or desirable. And Merrill Lynch has not demonstrated that national uniformity in the area of wage claims is vital, in some way, to federal securities policy. Convenience in exchange management may be desirable, but it does not support a plea for uniform application when the rule to be applied is not necessary for the achievement of the national policy objectives reflected in

the Act. Indeed, Congress, in the securities field, has not adopted a regulation system wholly apart from and exclusive of state regulation. Cf. *Rice v. Santa Fe Elevator Corp.*, 331 U. S. 218, 234-236 (1947); *Campbell v. Hussey*, 368 U. S. 297, 302 (1961). Instead, Congress intended to subject the exchanges to state regulation that is not inconsistent with the federal act. Section 6 (c), 15 U. S. C. § 78f (c), explicitly subjects exchange rules to a requirement of consistency with the Act "and the applicable laws of the State in which [the exchange] is located." "Where the Government has provided for collaboration the courts should not find conflict." *Union Brokerage Co. v. Jensen*, 322 U. S. 202, 209 (1944). And we observed in *Silver* that the scheme of self-regulation provides in some cases for no agency check on exchange behavior and, therefore, "[s]ome form of review of exchange self-policing, whether by administrative agency or by the courts, is . . . not at all incompatible with the fulfillment of the aims of the Securities Exchange Act." 373 U. S., at 359.

C. It is also argued that the applicable state laws referred to in § 6 (c) are the laws of the State in which the exchange itself is located. Thus, because the New York Stock Exchange is in the city of New York, it is said that "the applicable laws" are those of New York, and that the California court was in error in not applying New York law that would have compelled arbitration of this dispute and would have validated the forfeiture provision of the Profit-Sharing Plan.

We are not persuaded that this is what Congress intended. Section 6 (c) has no independent existence creating some sort of spurious uniformity of application for all States. It has meaning only in the context of the assertion of a federal interest, and it hinges on our determination that the particular rule be integrally related to or substantially effect the aims and purposes of the

Act. It merely requires that any exchange rule adopted outside the context of the Act be consistent with the laws of the State in which the exchange is located.¹⁶

If the rule is sought to be enforced in another State, normal conflict of laws principles come into play, and the rule's effect depends on the resolution of that conflict. Were this not so, there would be no purpose behind the choice-of-law clause in the Profit-Sharing Plan itself. More importantly, the uniform application Merrill Lynch's interpretation of the Act would purportedly foster is seen to be ephemeral when one considers that broker-dealers like petitioner are also members of exchanges located outside New York, and are therefore subject, under the "state of location" theory, to other States' laws. In effect, we are asked to sacrifice the individual's expectation of uniform treatment in the State of his residence for uniformity of application of the effect of an exchange's rules. We decline to do so because we believe that Congress intended that those elements of the old regime of complete self-regulation, that is, those elements not related to the federal objectives, be subject to state law and to established conflicts principles when their application out of State comes into controversy. After all, a stock exchange is organized as an association in

¹⁶ The Act contains other provisions indicating the intent of Congress that state law continues to apply where the Act itself does not. Thus, § 28 (a), 15 U. S. C. § 78bb (a), states that the rights and remedies provided by the Act "shall be in addition to any and all other rights and remedies that may exist at law or in equity." It further provides that nothing in the Act "shall affect the jurisdiction of the securities commission . . . of any State . . . insofar as it does not conflict with the provisions" of the Act "or the rules and regulations thereunder." Section 28 (b), 15 U. S. C. § 78bb (b), provides that nothing in the Act "shall be construed to modify existing law . . . with regard to the binding effect . . . of [exchange] action taken . . . to settle disputes between its members . . . on any person who has agreed to be bound thereby."

accordance with the laws of the State of its location. Any assertion of extraterritorial jurisdiction contends, of course, with the public policy of the State in which this jurisdiction is sought. To ascribe more to § 6 (c) would be contrary to the congressional scheme and to what might be regarded as common sense.

D. MR. JUSTICE BRENNAN has stated,

"The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U. S. 132, 142 (1963).

In other contexts, pre-emption has been measured by whether the state statute frustrates any part of the purpose of the federal legislation. *Colorado Anti-Discrimination Comm'n v. Continental Air Lines, Inc.*, 372 U. S. 714, 724 (1963); *Perez v. Campbell*, 402 U. S. 637 (1971); *Rice v. Board of Trade*, 331 U. S. 247, 253-255 (1947). And only last term MR. JUSTICE DOUGLAS, in speaking for the Court, observed that while prior cases on pre-emption "are not precise guidelines," because "each case turns on the peculiarities and special features of the federal regulatory scheme in question," it is where there is in existence a pervasive and comprehensive scheme of federal regulation that pre-emption follows in order to fulfill the federal statutory purposes. *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U. S. 624, 638-639 (1973).

In the area of regulation that we are considering here, California has manifested a strong policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relation-

ship. This policy prevails in the absence of interference with the federal regulatory scheme. We find no such interference and we also find in the structure of the Act an intent on the part of Congress that state policies in this area should operate vigorously.

E. It is suggested, finally, that the petitioner's Profit-Sharing Plan operates on a national level; that it is open to all eligible Merrill Lynch employees in the United States; that the employment of respondent and the class he represents is interstate in nature, as is Merrill Lynch's business; and that the application of the California statutes would unduly burden interstate commerce.

What has been said above provides the answer to this argument. It is in line with the principle, long established, that the National Government's power, under the Commerce Clause, to regulate commerce does not exclude all state power of regulation. *Southern Pacific Co. v. Arizona*, 325 U. S. 761, 766-767 (1945); *Brotherhood of Locomotive Firemen & Enginemen v. Chicago, R. I. & P. R. Co.*, 393 U. S. 129 (1968); *Huron Portland Cement Co. v. Detroit*, 362 U. S. 440 (1960).

The judgment of the Court of Appeal is affirmed.

It is so ordered.

MR. JUSTICE STEWART took no part in the decision of this case.

